Alcove 23
AM 1935
kn
c.1

Boston University
College of Liberal Arts
Library

THE GIFT OF The Author

Alcove 23
378.744
BO
AM 1935
Kn
c.1

53090

BOSTON UNIVERSITY

GRADUATE SCHOOL

Thesis

THE GUARANTY OF BANK DEPOSITS IN THE UNITED STATES

by

Asa S. Knowles

(A.B., Bowdoin College, 1930)

submitted in partial fulfillment of the
requirements for the degree of
Master of Arts
1935

H.E.L.

THE GUARANTY OF BANK DEPOSITS

IN

THE UNITED STATES

PART I

Digitized by the Internet Archive
in 2017 with funding from
Boston Library Consortium Member Libraries

https://archive.org/details/guarantyofbankde00know

THE GUARANTY OF BANK DEPOSITS IN THE UNITED STATES

TABLE OF CONTENTS

	Page
Preface	8
PART I	
Chapter One:	
Introduction	9
Chapter Two:	
Bank Deposit Guaranty and Bank Deposit Insurance	12
Insurance and Insurable Risk	13
Bank Deposit Guaranty and Scientific Insurance	15
Bank Deposit Guaranty and Assessment Life Insurance	20
The Importance of Reserves in an Insurance Program	22
Is Deposit Guaranty Deposit Insurance?	24
Chapter Three:	
The Guaranty of Time and Demand Deposits	26
Introduction	26
Banking	26
The Guaranty of Time Deposits	28
The Guaranty of Demand Deposits	29
The Nature of Commercial Deposits	30
The Significance of Demand Deposit Guaranty	34
PART II	
Chapter One:	
The Protection of the Public's Interest in the Banking Business Other Than Deposit Guaranty	37
Introduction	37
The Regulation of Bank Organization	39
Regulations Pertaining to Personnel and Directors of Banks	42
Regulation of Capital Requirements	45
Regulations Pertaining to Bank Management	47
Regulations Pertaining to Bank Supervision	52
Regulations Pertaining to Bank Liquidation	55

Page

Chapter One: (Cont.)

Double Liability of Bank Stock 56
Legal Reserves Against Deposits 57
Primary and Secondary Reserves 59

PART III

Introduction 62

Chapter One:

The New York Safety Fund 64

Introduction 64
The Safety Fund 65
The Safety Fund in Operation 69
Insurance of Deposits and Circulation 72

Chapter Two:

The Guaranty of Bank Deposits by States 76

Introduction 76
The Populist Movement 76
Characteristics of State Guaranty Funds 78
Legality of the Guaranty Fund Plans 78
Character of Deposits Guaranteed 79
Assessments 79
Additional Requirements 80
Investment of Guaranty Fund 80
Duties of Guaranty Fund Administrators 81
Methods of Paying Deposits in Failed Guaranteed Banks 81
Compulsory and Voluntary Guaranty Plans 84
Compulsory Systems 86
The Oklahoma Guaranty System 86
The Oklahoma System in Operation 90
Failure of the Oklahoma System 95
The Nebraska System 99
The Fund 99
Payments of Deposits in Failed Banks 100
Bankers Conservation Fund 101
Additional Banking Legislation 102
How Deposit Guaranty Worked in Nebraska 102

Page

Chapter Two: (Cont.)

The Outcome of Other Deposit Guaranty Systems 106
Deposit Guaranty in Mississippi 106
Deposit Guaranty in South Dakota 108
Deposit Guaranty in North Dakota 110

Voluntary Deposit Guaranty Plans 111
The Kansas System 112
The Fund 113
Banks Eligible to Join the Kansas System 114
Procedure When Bank Failed 115
The Failure of the First Voluntary Deposit Guaranty Plan 117
The Texas System 120
Results of Deposit Guaranty in Texas 123
Washington Plan 125
Bank Deposit Guaranty in the State of Washington 126

Chapter Three

The Results of State Bank Deposit Guaranty 128

Significance of Historical Study 128
The Political Factor 128
Effect of Deposit Guaranty Upon Banking Practices 131
The Growth of Deposits Under State Guaranty Systems 132
Deposit Guaranty on a State-Wide Basis 134

Chapter Four

Outstanding Weak Points in State Guaranty Systems 137

Chapter Five

State Laws Protecting Deposits in Savings Banks 141

Mutual Savings Central Fund Incorporated 141
The Wisconsin Law Protecting Savings Bank Depositors 143
The New York Deposit Guaranty Law 144

	Page
PART IV - POST WAR DEVELOPMENTS LEADING TO FEDERAL BANK DEPOSIT GUARANTY	146
Introduction	146
Chapter One:	
The Collapse	147
Chapter Two	
Temporary Relief Measures	152
Chapter Three	
Inadequacy of Relief Measures	155
Chapter Four	
The Emergence of Deposit Guaranty Legislation	158
Chapter Five	
The Federal Deposit Insurance Corporation	161
The Corporation	161
Management	161
Powers and Duties of the Corporation	161
Capital	162
Other Provisions Regarding Capital Subscriptions	164
Adjustment of Stock to Deposit Liabilities	165
Certification for Membership	166
Dividends on Stock of F.D.I.C.	166
The Temporary Insurance Provisions	166
The Temporary Fund	166
Member Banks of the Temporary Insurance Fund	167
Statements Required of Members in the Temporary Fund	168
Payments and Assessments	168
Amount of Insurance	169
Procedure When Member of Fund Closes	169
The New Bank	170
Procedure When State Member Bank Closes	172
Deposit Insurance Account	173
Assessments Against Class A Stockholders	173
Deposits Payable at Foreign Office	174

Chapter Five (Cont.) Page

The Permanent Insurance Plan 174
Amount of Permanent Insurance 175
Power to Issue Securities 175
Fund for Mutuals 175
Federal Deposit Insurance Corporation in Operation 177
Deposits Insured 177
The Fund 180
Withdrawals 180
Failures of Insured Banks 181
Assessments 181

PART V - THE CASE FOR AND AGAINST FEDERAL DEPOSIT INSURANCE LAW

Chapter One

Introduction 182

Chapter Two

The Case Against the Federal Law 183

A Study of What Would Have Happened to Bank Deposit Guaranty During the Years 1920-1932 183

The Blanket Assessment Defect 188

The Interest Argument 191

The Reserve Factor 193

Chapter Three

The Case for Federal Deposit Guaranty 194

Burden of Loss Shifted From Shoulder of Depositor 194

Restore Confidence 194

Put An End to Bank Runs 195

Distribute the Losses 195

Improve Banking Practices 196

Bank Deposit Guaranty and Check Currency 196

Page

Chapter Four

Possible Developments Under the Federal Law 198

Chapter Five

Bank Deposit Guaranty and Credit Insurance 200

Chapter Six

Summary and Conclusions 204

Summary 204

Conclusions 205
Deposit Insurance and Banking Reform 206
A Graduate School of Banking 208
How a Guaranty Law Could Be Justified 211

PREFACE

The "New Deal" has brought to the United States many significant social and economic changes during the past two and one-half years. Among these is the provision in the Banking Act of 1933 for guaranteeing bank deposits.

Bank deposit guaranty provides a challenge for every thoughtful citizen and student today. It not only affects the business of banking as conducted in the United States, but it creates problems of concern to every citizen and bank depositor.

This treatise on bank deposit guaranty brings together much of the significant information upon the subject on the basis of which it has been possible to draw several conclusions.

Material dealing with the recent federal law was abundant, whereas that pertaining to the history of bank deposit guaranty and certain other aspects of the subject was not at all plentiful. Among the many authors on the various phases of bank deposit guaranty, the writer is particularly indebted to Mr. Thomas B. Robb, the author of "Bank Deposit Guaranty"; Mr. Thornton Cooke, for numerous articles in the Quarterly Journal of Economics, and Mr. John G. Blocker, author of "The Guaranty of State Bank Deposits".

In addition, the writer wishes to thank the officials of the Federal Deposit Insurance Corporation in Washington, D.C., for furnishing current information pertaining to the Federal Deposit Insurance Corporation.

A debt of gratitude is also due Professor Charles P. Huse, Chairman of the Department of Economics, Graduate School, Boston University, for suggestions and criticisms.

Asa S. Knowles

PART I

Chapter One

There are in the United States today over thirteen thousand banks and banking institutions. When we stop to think of the part played in the community by these banks and their services, as we were obliged to do during the national bank holiday in March, 1933, we realize that our entire commercial and industrial structure is just as sound as is our "banking system". Not only does the soundness of the commercial and industrial structure of the country depend upon the soundness of the banking system, but it is also true that the soundness of the banking structure of any country depends, to a large degree, upon the general business conditions prevailing in the country at any given time. Because of the chronic industrial situation existing in the United States at the beginning of the year 1933, many banks which would command the confidence of the public in ordinary times, were subjected to extraordinary circumstances. These banks not only had to meet unusual demands for deposits on the part of the customers, but were forced to meet so-called "runs" or heavy withdrawals by vast numbers of people who feared for the safety of their bank accounts. In addition, the banks were obliged to "write off" large shrinkages in investments which had been made in good faith; the market value of these securities having declined. A fourth factor was the necessity of the banks carrying along or renewing notes of the customers which would be paid eventually, but which could not be turned

into cash in a short time.

The combination of these factors and many additional ones, placed the banking network of the country in such serious straits that it became necessary, in early March 1933, to declare, by presidential proclamation, a national bank holiday. This holiday lasted for some days pending the attempt on the part of the bankers to put their houses in order. During this period both the National and State Governments had to enact some emergency legislation to provide relief to the depositors in the closed institutions, to safeguard the depositors and other creditors of the banks, as well as to protect the interest of the general public.

The experiences of the bank holiday in March 1933 left no doubt in the minds of many of the country's legislators in Washington that something had to be done to prevent the recurrence of a similar situation. Out of many proposals for building a banking system that would not be at the mercy of the depositing public in times of severe stress, there grew a movement in favor of "insuring" or "guaranteeing" the payment of bank deposits to those having deposits in banks.

This idea of attempting to guarantee the payment of depositors was not new. It had been tried by several of the western states within the same quarter century period, and had had an historical precedent in the nineteenth century when New York had its "safety fund".

On June 16th, 1933, the President of the United States

approved the Banking Act of 1933 which provided for the creation of a Federal Deposit Insurance Corporation. This Corporation had for its purpose the building of greater public confidence in the banks of the United States by providing insurance against the loss of deposits in banks.

The deposit guaranty program of the United States has been in operation for a relatively short period of time, but already the law has caused much discussion and controversy. Many question the wisdom of its enactment; others question the value of its retention upon the statute books of the country; some doubt if it would be a real safety valve in time of stress; others wonder how long it can continue, and what its future course will be when it has passed the formulative stages.

It is important, therefore, to make a study of bank deposit guaranty in the light of what information we have about it, for the value of any program is seen only when it is carefully studied and observed, after which some conclusions may be formulated in terms of certain facts and circumstances.

The following pages will be devoted to the presentation of the distinction between deposit guaranty and deposit insurance; the insurance of commercial deposits and savings deposits; the historical background of deposit guaranty; the arguments for and against a guaranty system; the Federal Deposit Insurance program, its organization, operation, and significance to banking operations in the United States.

Chapter Two

BANK DEPOSIT GUARANTY AND BANK DEPOSIT INSURANCE

Ever since the proposal and enactment of bank deposit guaranty laws there has been considerable controversy as to whether or not any scheme which is designed to protect depositors against loss when a bank fails should be named a bank deposit guaranty system, or a bank deposit insurance system. Some feel that such systems are purely "guaranty systems" having none of the usual aspects of insurance because the funds to pay depositors of closed banks are obtained by assessing other banks, while others feel that even the assessment of banks to cover losses is a special type of insurance and within the meaning of the word "insurance". For example, Mr. Robb in his book "The Guaranty of Bank Deposits", has attempted to prove this latter contention.[1] Others think that the insurance element is completely lacking unless adequate reserves are built up to take care of losses. Furthermore, those who enacted the Federal law protecting depositors against the loss of money when a bank fails, talked in terms of "bank deposit guaranty" and "bank deposit insurance" as though both phrases were synonomous. In addition, there is the question of there being an "insurable interest" in bank deposits when viewed from the point of view of the depositor.

To answer this question as to just what is "bank deposit

[1] "The Guaranty of Bank Deposits", Thomas B. Robb, Houghton-Mifflin Company, Boston, 1921 -- Pages 31-42

insurance", it is necessary to examine closely the fundamental aspects of "insurance" and then see whether or not a deposit guaranty program can meet the requirements essential to place it in the class of insurance. Furthermore, we must examine the contentions of those who understand insurance fundamentals and still claim "deposit guaranty" is "deposit insurance".

However, an analysis of the insurance features of bank deposit guaranty must be based upon an understanding of the fundamentals underlying insurance and insurable risk.

Insurance and Insurable Risk

Because there are so many risks in the economic world today and because the majority of human beings have not sufficient wealth to stand the loss of property and other forms of wealth, there has grown up an enormous business whose function it is to assume risks for others. For a fee determined in accordance with the nature, degree, and value of the risk involved, these concerns or individuals guarantee to others financial indemnification for loss of wealth or income.

A. H. Mowbray in his text entitled "Insurance, Its Theory and Practice in the United States" defines an insurance contract as follows: "Stripped of all the verbiage involved in designating the risk, and in defining how loss shall be proved, it is a promise of one party (the insurer) that in consideration of the payment, or the promise of payment, of a sum of money (the premium) by the other party (the insured), the first party will, in case the risk eventuates in loss of a cash value, pay to the

other party that cash value, usually up to an agreed maximum limit."[2]

In order to take insurance and have one's policy valid, it is essential that one have an "insurable interest".

C. J. Crobaugh in his "Handbook of Insurance" states the following about insurable interest: "It is an important doctrine in insurance that the person securing the benefit of the insurance must have some real interest in the subject matter insured. Such interests may be described in a general way as interests which persons have in the subjects of the insurance so that they will be benefited by the continued existence of the subject matter or will suffer a direct and immediate loss by the destruction or injury of such subject matter. For example, a person has an insurable interest if he stands in such a legal relationship to the property as to benefit by its continuance or be prejudiced by its being damaged or destroyed."[3]

"The extent of the insurable interest in the subject matter insured may be measured by the amount of loss the person would suffer if the subject matter were destroyed or damaged." [4]

"Insurable interest is a more extensive term than the word 'property' or 'estate', for it refers to any benefit or advantage which may be derived from the thing." [5]

"It has been asserted that there is insurable interest where there is a direct or reasonable degree of probability of pecuniary interest to be secured from the continued preservation of the subject of the insurance."[6]

---

[2] "Insurance, Its Theory and Practice", A. H. Mowbray, (McGraw Hill Insurance Series), New York -- Page 49

[3] "Handbook of Insurance", C. J. Crobaugh, McGraw-Hill, New York, Pages 705-709

[4] Ibid.

[5] Ibid., Page 707

[6] Ibid.

When one appreciates the real meaning of the term "insurable interest" as defined by Mr. Crobaugh, there can be little doubt in his mind about the insurable interest of anyone who has a bank account. The extent of this insurable interest is considerable. Mr. Crobaugh says: "The extent of the insurable interest in the subject matter insured may be measured by the amount of loss the person would suffer if the subject matter were destroyed or damaged."[7] Anyone who witnessed the untold suffering of those who lost their entire savings by means of bank failures in 1932 cannot deny that there can be no safeguard too great to secure the savings of those who have to rely upon the banks to protect their life's savings. To those who have little wealth, the loss of the savings of the family is an irreparable calamity leading to untold misery in many instances; and even to the man who possesses great wealth, the loss of very much of his cash in the bank causes him to make considerable adjustment in his mode of living. It seems almost self-evident, therefore, that any owner of a bank deposit has a very definite insurable interest. The depositor has a direct and appreciable interest to be secured from the continued preservation of the subject of insurance, the bank account.[8]

Bank Deposit Guaranty and Scientific Insurance

Having determined that there is an insurable interest in bank deposits owned by the general public as depositors, it is now proper to inquire whether or not a system of bank deposit guaranty can meet the requirements of scientific insurance. This

[7] "Handbook of Insurance", C. J. Crobaugh, McGraw-Hill, New York, Page 707

[8] Ibid.

may be determined in a satisfactory manner by a comparison of bank deposit guaranty procedure with the principles of scientific insurance.

A well administered insurance company has the constant aim "to secure a homogeneous group". This is accomplished by classifying risks that are of the same nature into their proper categories. It is not always possible to have all the risks exactly alike, but experience is helping insurance companies to make better distinctions among risks. A classification of risks in accordance with the best judgment available has two outstanding advantages in the administration of scientific insurance:[9] (1) The administrative procedure of the insurance company is simplified in that the hazards of different risks are readily available for purposes of setting the rates to be charged on a given subject of insurance. (2) The costs of insurance are more equitably distributed among those whose interests are being insured, thus tending to distribute more widely the benefits of insurance.[10]

In addition to selecting risks, scientific insurance sets up different premium rates for the different types of risk being insured. This principle recognizes that the cost of the insurance should be in proportion to the benefit derived by the person whose interest is protected, as well as the likelihood of loss so far as the insurance company is concerned.[11]

In contrast to the foregoing procedure, a program of bank deposit guaranty as practiced in those states having compulsory systems, under which all banks must participate, all the banks

---

[9] "The Guaranty of Bank Deposits", Thomas B. Robb, Houghton-Mifflin Company, Boston, 1921 -- Page 31

[10] Ibid., Pages 31-42

[11] Ibid.

are forced into the system and then the same rate is charged to all. Such a procedure would seem to violate the requirements of scientific insurance. In the first place it appears that no selection of banks is made, and that the rate is the same for every bank whose deposit liabilities are guaranteed.

However, those who are familiar with the regulation and supervision of banks, know that this is a way of making a selection of risks. The "rigid" supervision of banks made by the state is a selection of risk. State supervision establishes a minimum standard and then charges a uniform rate to all meeting the standard.

It can be maintained, therefore, that the guaranty of bank deposits under the compulsory system is a matter of insurance, the deposit guaranty program being a compulsory insurance company administered by the state.[12]

The selection of risk by the insurance company is still haphazard guesswork in many cases, insufficient materials being available upon which to base sound conclusions. In the past this kind of guesswork has determined much of our marine and fire insurance.[13] Provided a state deposit guaranty system establishes a minimum, and provided it is properly administered, one cannot say that it is any less scientific than other kinds of insurance.

The same arguments hold for the voluntary bank deposit guaranty system, under which banks may participate or not at their will because the system in operation is practically

12 "The Guaranty of Bank Deposits", Thomas B. Robb, Houghton-Mifflin Company, Boston, 1921 -- Pages 30-33

13 "Bank Deposit Guaranty, The Insurance Aspects of the Problem", C. L. Jamison, Bankers' Magazine, Vol. CXXXVI (Jan. to June 1933) -- Page 453

compulsory. Those banks which choose to become "guaranty banks" are bound to be favored by depositors in that the depositor wants to feel that his money is safe, thus other banks outside the system are forced to join the system to hold on to deposits and gain new accounts.[14] Furthermore, the same degree of selection through supervision is made, and all pay the same rate.

This analysis and comparison between scientific insurance and bank deposit guaranty may be carried further. A comparison of deposit guaranty with scientific life insurance is highly desirable because life insurance is the most scientific of the insurance programs.

Life insurance companies establish minimum standards in order to classify individuals into certain age and health groups, and then charge them a uniform rate according to the classification. This is done in spite of the fact that no two lives were ever created equal. On the other hand, no two banks were ever created equal, but the subjects of insurance present less of a risk hazard than the subjects of life insurance. When a person's life is insured, he is not kept under constant supervision, as is the bank, but is turned loose to run at will. When a man knows that his family is protected against want in the event of his death, he is apt to become less careful of his habits of living, thereby increasing the element of risk to the company insuring his life, whereas a bank deposit guaranty risk is kept reasonably constant through supervision. Furthermore, just as the life insurance company rejects the undesirable risk, so does

[14] Quarterly Journal of Economics, November 1913 -- Pages 69-114

the State refuse to guarantee the deposits of an insolvent bank, while the constant regulation of banks continues to eliminate the undesirables that were able to get under the ropes when the system started. Once a man's life is insured, the insurance company must carry the risk so long as the policy is not allowed to lapse.[15]

Just as the life insurance company has its physical examinations, so does the state establish exact moral and ethical standards for men who desire to enter the banking business. In addition, the state has definite figures to determine risk.

In the life insurance business, the payments to the beneficiaries of the subjects insured increase as the life insurance companies grow older, whereas in the case of a bank, the age element is of no consequence; if anything, the hazard decreases with age because the experience of the managers of the bank widens.

It can be pointed out that the amount of loss in life insurance is definitely known, and the premiums so established as to pay the losses, and cover costs of doing business; while the losses of bank deposit insurance are not so easily ascertained. However, when a bank fails it is because a person refuses to repay what he borrowed from the bank. To what extent the credit risk may be collected[16] and when, is extremely problematical, but it is certain that all bad loans will not be a total loss. Therefore, this does not place bank deposit guaranty at a great disadvantage in that there is a chance that there will be no loss at all, the bank being repaid in full when borrowers in default

15 "Handbook of Insurance", C. J. Crobaugh, McGraw-Hill, New York Pages 237-241

16 "Bank Deposit Guaranty, the Insurance Aspects of the Problem", C. L. Jamison, Bankers' Magazine, Vol. CXXXVI (Jan. to June 1933) -- Page 453

regain financial strength.

In conclusion, it can be said that although bank deposit insurance is a compulsory program for all subjects when in operation, it is not less scientific than is the life insurance program, except for the fact that a definite amount of loss may not be determined in advance. However, the failure to calculate the amount of loss, does not detract from the value of comparing the scientific aspects of the two.

Bank Deposit Guaranty and Assessment Life Insurance

One of the fundamental principles of state bank deposit guaranty systems is the creation of a fund from which to pay the claims of depositors in banks which fail. Each bank participating in the guaranty system, is assessed a certain percentage of its average deposits, for the purpose of creating this fund. Because of this assessment feature of the deposit guaranty systems, a comparison of the insurance of bank deposits under a guaranty system with assessment insurance companies cannot be neglected.

Some people believe that there can be no real insurance when the system which is providing the insurance does not set up some sort of a reserve fund to be placed at compound interest and which is sufficient to meet each loss as it occurs. Those who hold this view, state that deposit insurance is assessment insurance and, therefore, is doomed to failure on the basis of the experience of the assessment life insurance companies.

It is true that the assessment life insurance companies have not met with great success. However, the fundamental cause

for this failure is removed in a bank deposit insurance program. Assessment life insurance has failed because the risks that are underwritten have increased as the age of the policyholders has progressed.[17] As the companies grew older, the assessments became intolerable. Such is not the case in bank deposit insurance. The age element does not affect the bank except to increase its prestige, and to increase the experience of the bank management.

Contrary to the apparent failure of the assessment life insurance companies, there is another form of assessment insurance which has had a marked degree of success. The fire insurance program which is conducted by the "County Mutual Insurance Companies" in the middle west has been successful.[18] In these County Mutual Insurance companies the risks are practically all equal; they cover the same kind of property which consists of middle west farm properties for the most part. Furthermore, the risks of the insurance are approximate in size and small in amount in that the majority of these farm properties have about the same number of buildings of the same type which are established on a moderate scale. Another advantage of these risks is the distance apart; thereby the danger of an excessive conflagration that might spread over a large area is minimized considerably. Therefore, it is not likely that these companies will be subjected to indemnification of many losses at the same time. In addition, the participants are not overburdened when a loss occurs.

[17] "The Guaranty of Bank Deposits", Thomas B. Robb, Houghton-Mifflin Company, Boston, 1921 -- Page 33

[18] "Insurance, Its Theory and Practice", A. H. Mowbray, McGraw-Hill Insurance Series, New York -- Page 319

In contrast, the insurance of bank deposits are practically all unequal. The insurance of deposits in a small bank in Vermont is not at all comparable to the insurance of deposits in a large metropolitan bank. Not only are the number of depositors and size of deposits in different categories, but the qualities of the management are dissimilar. This inequality does not defeat the deposit insurance program, however, so long as each bank contributes to the insurance fund in accordance with the size of its deposits, or ability to pay. A failure of a large bank might work a greater hardship on a small bank than it would on another large bank, but this temporary inconvenience of meeting an extraordinary assessment can be overcome to a degree by setting proper statutory limits upon assessments.

The Importance of Reserves in an Insurance Program

It has been stated already that some people believe that the creation of reserves is absolutely fundamental to insurance. It is important to examine this contention carefully.

The act of Congress in 1933 which created the Federal Deposit Insurance Corporation termed its guaranty program "bank deposit insurance".[19] The use of these two terms synonymously caused the Committee on Banking Law and Practice of the Association of Reserve City Bankers to examine carefully the exact meaning of this term "bank deposit insurance". The Commission conducted a careful investigation, the results of which were published in one of its bulletins. The bulletin contains this statement: "In the law as written the guaranty plan is referred

[19] Act of 73rd Congress entitled "Banking Act of 1933"

to not as a guaranty of bank deposits, but as an insurance plan. There is nothing in the plan that entitles it to be classed as insurance. Insurance involves an old and tried principle. The essence of insurance is the payment by the insured of premiums in actuarial relation to the risk involved. Under the terms of the permanent plan, however, the costs or premiums are not charged according to the risk. There is no penalty for bad management. If the premium could be assessed according to the hazard, the insurance plan might be used as an instrument of reform. The cost to the badly managed bank or the uneconomic bank would be so high as to force the changes, reorganizations, or reforms necessary to secure lower premiums."[20]

It is pointed out also that the guaranty plan departs from insurance principles in these ways: It brings the heaviest losses upon banks during periods of adversity, while in periods of prosperity there will be few failures or assessments. In order to avoid overtaxing a bank in times of stress there should be a reserve fund created as "would be the case under a true insurance plan."[21]

The foregoing statements by the Commission on Banking Law and Practice of the Association of Reserve City Bankers not only disagree with the foregoing contentions that bank deposit guaranty is bank deposit insurance, but state that such plans in order to be classified as insurance, should collect regular premiums and create reserves for the payment of losses.

The insurance reserve fund, according to C. J. Crobaugh,

---

20 Bulletin No. 3, Committee on Banking Law and Practice, Association of Reserve City Bankers -- Pages 27-28

21 Ibid., Page 28

"is a sinking fund, accumulated from premium payments and compound interest for the purpose of meeting policy obligations as they fall due ..... the main reason for the reserve is to maintain in trust for the exclusive right of policyholders a sum equal to the unearned part of premium already collected."[22]

In reply to the contention of the Committee on Banking Law and Practice that the creation of reserves to indemnify for losses is fundamental to all insurance, it may be stated that insurance that creates reserves from premiums is one kind of insurance and may be called "reserve insurance", and this kind of insurance does contribute the bulk of the insurance business in the country. On the other hand, any system which protects one against financial loss upon some predetermined basis is insurance. For example, even though reserves are not established by the "County Mutual Insurance Companies" in the middle west, the insurance program is successful. These companies insure farms against loss from fire, and assess their losses against the insured farmers.

Is Deposit Guaranty Deposit Insurance?

Fundamental to all insurance contracts there must be an "insurable interest", and it was stated early in this discussion that there can be little doubt about the existence of an insurable interest in the deposit owned by the creditor of a bank. Therefore, an insurance program exclusively for the bank depositor is not impossible under the law.

The question as to whether a system for guaranteeing bank

22 "Handbook of Insurance", C. J. Crobaugh, McGraw-Hill, New York, Page 1142

deposits can meet the requirements of scientific insurance has been discussed and it has been found that bank deposit guaranty is conducted on a basis much like that of the scientific insurance companies. The participants in a deposit guaranty system must be subjected to the same classifications, standards, and examinations before being accepted into the system as the subjects for other types of insurance conducted on a scientific basis. The fact that the guaranty systems are compulsory insurance systems in name or status does not alter this conclusion. Furthermore, it has been found that bank deposit insurance has an advantage over ordinary insurance in that the subjects of insurance under the latter programs are allowed to become lax when the risk is covered, whereas the bank deposit guaranty system keeps its subject under constant surveillance.

It has been concluded also that although bank deposit insurance is assessment insurance, this factor does not doom it to failure. Assessment insurance has been and still is conducted on a successful basis.

Finally, it has been concluded that reserves are not essential to an insurance program, the type of insurance which creates reserves being only one type of system providing protection.

Therefore, it can be concluded that bank deposit guaranty is really bank deposit insurance. A bank deposit guaranty system which assesses its losses against those whose deposits are being protected, and to whom the benefits of the system accrue, is <u>similar</u> to what is known as "assessment insurance".

Chapter Three

THE GUARANTY OF TIME AND DEMAND DEPOSITS

Introduction

The significance of a system for guaranteeing "bank deposits" cannot be fully appreciated until it is analyzed in the light of the nature of the deposits which are being protected. Deposit guaranty systems insure both "time" and "demand" deposits, but the two are quite dissimilar in their importance to the banker and the public. The guaranty of deposits in the savings bank field has no real significance outside of being a promise to indemnify a depositor against loss when a bank fails, while the guaranty of commercial bank deposits involves not merely the protection of a different class of deposits, but it affects commercial bank credit, commercial banking practices, and check currency.

Therefore, in order to understand bank deposit guaranty in its relation to banking and business, it is important to examine carefully not only what is the banking business, but what are its functions, and how these are affected by a guaranty system.

Banking

The term "banking" is subject to much abuse, and is used in a popular sense to designate almost any type of activity which pertains to the handling of money, securities, mortgages, etc.

When the term is properly used, it means the gathering together of funds, usually in relatively small amounts, to lend

to industry and commerce.[23] Upon these amounts of money so gathered together a rate of interest is paid which is ordinarily below that received by the bank for its loans, the difference or spread being the source of the bank's profit after it deducts its cost of doing business.

There are other agencies and institutions whose business is tied up with banking, but to which the name "bank" cannot be applied when it is used correctly. For example, an investment house underwrites and sells securities which are bought by banks. Even though these firms act as an intermediary for obtaining the capital wanted by industry, they are not banks, and do not perform the services expected of banks.

Within the meaning of our definition, it is possible to classify banking institutions into two broad classes: (1) commercial banks and (2) savings (investment) banks.

The commercial bank has for its function the receiving of funds on deposit subject to demand, and the making of short term loans. By the expression "short term" is meant loans which run for a duration of a few months (sixty to ninety days). The proceeds of these loans are usually used to buy or move merchandise, crops, etc., the loan being discharged when the transaction is completed.[24]

The savings bank or savings department of a bank receives funds on deposit which are expected to be left for a longer period of time, and not subject to immediate withdrawal. A large part of the deposits of savings banks are loaned to in-

23 "Banking", F. A. Bradford, (Longman's Economic Series), Longmans Green Company (1933) -- Page 2

24 "Banking Theory and Practice", Harr and Harris, McGraw-Hill, Page 11

dustry indirectly by means of purchasing securities, the maturity or due date of which may be several years distant.

The Guaranty of Time Deposits

There are two types of savings bank when classified according to their purpose. One is called a mutual savings bank, and the other is a stock savings bank. The mutual savings bank is organized for the benefit and protection of depositors only. The only capital it has consists of the deposits made by the depositors and whatever income derived from these deposits that has been retained for the protection of the organization. The stock savings bank on the other hand has for its purpose the earning of profits over and above expenses which will accrue to the stockholders who have donated so-called paid-in capital to the bank. The mutual savings bank profits accrue only to depositors as dividends after the payment of expenses and setting aside certain necessary reserves. Interest (dividends) on deposits for the mutual bank is a division of profits[25], while for the stock bank it is a fixed expense paid for the use of capital. For the mutual savings bank, a declaration of dividends increases its assets, whereas a declaration of dividends for the stock savings bank is a return on paid-in capital and a liability of the bank to stockholders.[26]

There are many factors which may contribute to bank failures but in the last analysis, a bank failure is a condition of affairs under which a bank owes more to its depositors than it has good assets to meet these obligations. In other words, the

[25] Massachusetts General Laws, Chapter 168, Section 47
[26] "Banking Theory and Practice", Harr and Harris, McGraw-Hill, Page 13

deposit liabilities of the bank exceed the assets, capital, and surplus of the bank. When this situation arises, the bank is declared insolvent, its regular affairs are ended, and the bank is liquidated. The bank has failed to invest its funds in investments sufficiently sound to preserve the solvency of the institution. In the majority of the investments made there is no connection between the holder of a deposit and the investment of the deposit. Furthermore, when a savings bank invests money, the amount that may be invested may not exceed the deposits, guaranty, surplus, and other special funds, i.e. it cannot create credit as does the commercial bank for the purpose of making a loan or investment.

The guaranty of time or savings deposits, therefore, does not require a careful analysis to ascertain what the significance of the deposits may be, it is merely a promise to indemnify the holder of a deposit right in a savings bank when the bank is found to be incapable of meeting its total deposit liabilities. Furthermore, the savings deposit has no place in the circulation of currency used by the business world.

The Guaranty of Demand Deposits

The savings bank receives a deposit and acts as a mechanism to place that money at the disposal of industry. It meets industry's long term capital requirements. On the other hand, there is the commercial bank whose sole function is to meet the short term capital needs of business and industry. The commercial bank may lend money which has been deposited with it for

safe keeping, but the major portion of its loans consist of an extension of bank credit, i.e. the bank allows borrowers to draw drafts upon it. A deposit is created and the drafts or checks are drawn against it. The deposits of the commercial bank are approximately equivalent to its loans, and in most cases the deposit arises out of the loan.[27]

A clear understanding of the significance of demand deposit guaranty requires a discussion of the nature of commercial deposits.

The Nature of Commercial Deposits

Those who are not familiar with commercial banking as it is practiced in the United States are inclined to think of its activities in a very narrow sense, and think that the commercial bank is merely an instrumentality for collecting together the surplus funds of the community and lending them to those in need of "short term" loans, as opposed to the savings bank which meets the needs of long term capital requirements. The commercial bank does more than collect surplus funds; it collects these funds and uses some of them as a basis for "bank credit" which increases many fold the amount of purchasing power available to borrowers. One who borrows from a commercial bank gives the bank his promise to pay which is secured by a pledge of assets or collateral. In exchange for this promise to pay the bank may give the borrower cash for his promise, or it may credit the amount of the loan to his account against which the borrower may draw checks[28]. In the latter instance the bank is creating

[27] "Banking Theory and Practice", Harr and Harris, McGraw-Hill, Pages 128-132

[28] Ibid.

a deposit or manufacturing bank credit. (At the same time, the bank made a loan and created a checking account deposit.) To the commercial bank this checking system is just a right to draw from one account to another.[29] When the bank cannot make the transfer on its own books, banks do it among themselves through a clearing house. In this way the bank needs less cash to operate, and can extend greatly its bank credit. The bank continues to loan in this way until its loans equal five or six times the cash account on hand. If the borrower demanded cash in every instance this system would not function at all.

From what has been stated already it would seem that a commercial bank's lending power must depend upon the amount of cash deposits it receives and keeps on hand both as a reserve and to meet demands for cash withdrawals. This situation is true only for those banks outside of the Federal Reserve System. To understand the limitation placed upon these banks which belong to the Federal Reserve System it is essential to discuss in detail the nature of the so-called "reserve account" of member banks. A member bank is a bank which has met the requirements of and joined the Federal Reserve System.

In the Federal Reserve System each District Bank acts as a depository for the legal reserve against deposits required by statute of the "member banks" of the system. For this purpose each member bank maintains a "deposit reserve account" at the Federal Reserve Bank.[30] For Central Reserve City member banks the legal reserve against deposits is 13% of deposits; for

[29] "Banking Theory and Practice", Harr and Harris, McGraw-Hill, Pages 128-132

[30] "Contemporary Banking", Willis, Chapman, and Robey, Page 582

Reserve City member banks the reserve is 10% of deposits; and for other member banks this reserve is 7% of deposits. The chief value (see footnote) of this reserve against deposits is to check the expansion and contraction of credit of member banks to customers. It is recognized that practically all commercial loans result in the creation of deposits since the commercial bank is allowed to set up for its customers "credits to account" against which checks may be drawn in exchange for customers' promise to pay. Against these "created deposits" a reserve must be kept. The balance in the member bank's reserve account determines that bank's potential credit expansion or loans to customers. For example, in the case of the Reserve City bank, it is theoretically possible for this bank[31] to expand its credit approximately ten times the amount of its reserve account balance. A reserve account of ten dollars would allow credit expansion or member bank loans to customers amounting to $100. (Actually deposits are expanded approximately six times the reserve account.) Now if a member bank of the Federal Reserve System wished to increase its potential expansion of credit, it could increase its reserve account by rediscounting some of its eligible and acceptable paper[32], or paper that meets the legal and credit requirements of the Federal Reserve System. An increase in the member bank's reserve against deposits above that necessary to cover its present deposit liability makes possible

Footnote: The value of the legal reserve as a means of protecting the depositor is discussed on pages 47, 48, and 49.

31 "Banking Theory and Practice", Harr and Harris, McGraw-Hill, Pages 128-132

32 Ibid.

an increase in created deposits or loans. The rate of discount charged by the Central Bank will determine whether or not it is profitable for the member bank to discount this paper which has been discounted by it for one of its customers. When the Federal Reserve Bank discount rate is raised, member banks curtail their discounting to build up their reserve accounts and the expansion of credit or making of additional loans on the part of the banks to their customers is curtailed, and conversely a lowering of the Federal Reserve discount rate encourages an expansion of credit.

The role of the reserve account in the control over credit expansion and contraction is more clearly demonstrated in a discussion of its use in connection with the carrying on of "Open Market Operations". In the Federal Reserve System the "Open Market Committee" goes into the market and buys acceptances and securities, for which it pays by checks drawn on the Federal Reserve Banks. The recipients of these checks deposit them in their respective private banks, and eventually they find their way into "clearing" in the Federal Reserve Banks. The clearing proceeds are added to the "reserve accounts" of the member banks, thus increasing the potential expansion of credit for the member bank to whose account the clearing proceeds were added.[33] The member bank may refuse to use this excess reserve as a basis for loans, and the whole program becomes ineffective. The contraction of credit is accomplished through the reversal of this procedure. Bonds or acceptances are sold in the "open market" by

[33] "The Federal Reserve System in Operation", E. A. Goldenweiser, McGraw-Hill -- Pages 54-62 and 80-82

the Federal Reserve Banks and are paid for largely by checks on member banks. When these checks on member banks are cleared, their respective reserve accounts are diminished, thus curtailing the expansion of credit. This curtailment may be offset somewhat by the member bank by a deposit of excess cash in its reserve account or by discounting eligible and acceptable paper held in its portfolio.

The Significance of Demand Deposit Guaranty

More than ninety per cent of the payments which arise out of business transactions today are settled by means of checks drawn against bank accounts.[34] These checks afford great conveniences to business men. One may write a check for an odd sum; it is not necessary to keep on hand large sums of cash to settle accounts, and, thereby, one can avoid the risk of being robbed of his money. In addition, the check is made payable to a specific person and serves as an excellent receipt when endorsed by the payee.[35] The business world has confidence in the credit of the banks upon which these checks are drawn, whereas a draft upon a person whose credit is not known would not be accepted so readily. The commercial bank acts as a mechanism for converting the credit of a business man which in his name alone has limited acceptability into credit of greater acceptability. At the same time the bank turns the non-liquid assets of a business man into liquid assets when it accepts his note for a loan, the security for the note being the business and its assets.

[34] "Banking, Theory, and Practice", Harr and Harris, McGraw-Hill, Page 136

[35] Ibid., Pages 119-121

The discussion pertaining to the nature of commercial deposits demonstrated that the commercial deposit is the basis for a check currency used by the business world today. It follows, then, that a guaranty of the payment of these commercial deposits is a guaranty of the check currency.

During the banking holiday of 1933, when the credit of most banks was open to question, there was a hesitancy on the part of business men to accept checks drawn upon certain banks. There was a doubt concerning the time that would be required to collect the face amount of the check. If there had been a bank deposit guaranty system at that time insuring the bank account of each depositor up to a certain limit, these doubts would have been substantially reduced.

The guaranty of commercial deposits, therefore, is not merely a guaranty of payment to the depositor but is a system which insures the holder of a check drawn against such deposits that it will be accepted and paid. It is a scheme for securing the present day "check currency". This scheme is quite comparable to the Safety-Fund System of New York State established a century ago when the State of New York assessed banks to provide a fund to assure the payment of bank note circulation (see Pages 64-74). It was important to business men then to know that the medium of exchange would not entail loss when the bank issuing it failed and, therefore, would not circulate at a discount or be refused as money altogether.

It is not desirable at this point to discuss the desirability

of guaranteeing the payment of commercial deposits. It is desired only to indicate here the significance of a commercial deposit program under a system where such deposits make up a large part of the circulating media.

PART II

PART II

Chapter One

THE PROTECTION OF THE PUBLIC'S INTEREST IN THE BANKING BUSINESS OTHER THAN BANK DEPOSIT GUARANTY

Introduction

Ever since the enactment of legislation pertaining to the organization, regulation, and conduct of banks and banking institutions there has been a growing tendency on the part of those to whom the making of such laws are entrusted to give increased protection to the bank depositor. In fact much of the legislation which pertains to banking is a recognition of the public's stake in the banking business. The conduct of banking on a sound and conservative basis is a matter of great concern to every citizen, for without confidence in the banking structure, the nation cannot carry on its business in an accustomed and normal manner. On the other hand, there are a great many laws which are designed to protect the bankers, such as laws to prohibit too many banks in one locality, which would make profitable operation impossible.

The laws which regulate the banking system of any country are a product of evolutionary development. They recognize certain conditions which exist or have existed in their relation to the conduct of banking.

The guaranty of bank deposits by law had its origin in the desire of the legislators to instill greater public confidence in the banking structure of a particular state or, more recently, a nation. For example, the enactment of the legislation providing

for the establishment of the Federal Deposit Insurance Corporation in 1933 came at a time when public confidence in banks had been badly shaken, and one must admit that such legislation was not entirely unwarranted. Banks could not stand additional "runs".

However, the significance of Deposit Guaranty Laws and the philosophy underlying their enactment may be better understood if one is better acquainted with the attempts of the law making bodies in this country to protect the interests of depositors in American banks.

It is difficult for the average citizen to appreciate the many safeguards that are set up for his benefit and protection in his dealings with his bank. In the first place, the regulatory authorities do not allow anyone who so desires to enter the banking business, nor do they allow those who can meet the requirements and become bankers under the law to conduct their business wherever they desire. The establishment of the bank at a place where banking facilities are needed must be done by compliance with strict rules and only after the accumulation of a specified sum of "capital", and the election of responsible men to manage the institution. As soon as the bank is established, the state specifies to varying degrees how it shall be run, and carefully regulates the institution by making periodic examinations in order to assure itself that the law is being complied with insofar as the operation of the bank is concerned. (The degree to which banks are regulated and supervised varies

with the state; some states are extreme in regulation of banks and others are lax, while the majority follow a middle course which allows relative free rein to the bank under careful supervision until something goes wrong.)

Finally, when a bank fails to comply with the law in regard to its operation or becomes insolvent, it is taken over by the state which proceeds to run or liquidate the bank in the best interests of the depositors.

In order to understand exactly how the regulatory authorities protect depositors from suffering losses at the hands of careless or unscrupulous bank managers, it is desirable to examine in detail some of the statutory provisions which pertain to these matters.

The Regulation of Bank Organization

In the organization of a savings bank in Massachusetts, the following procedure is necessary: Twenty or more persons must associate themselves by an agreement in writing for the stated purpose of forming a corporation, giving the proposed name of the corporation together with its purpose and the city, town, or district where it intends to transact business. To this agreement each party must subscribe his name, occupation, residence, and post office address.[36]

The subscribers to the agreement notify the Board of Bank Incorporation of their intention to form a savings bank and apply for a certificate "that public convenience and advantage will be promoted" by the establishment of the proposed bank.

[36] Massachusetts General Laws, Chapter 168, Section 7

Upon receipt of the application, arrangements are made for a time and place for a public hearing, and for three weeks prior to this hearing the would-be incorporators must publish a form of notice of the proposed incorporation furnished by the Board of Incorporation in one or more newspapers in or near the town where it is proposed to locate the bank. (If the certificate of incorporation is refused after these proceedings, the application may be renewed subject to the same conditions after one year from the date refused.)

After it is known that the certificate of incorporation will be granted, it is necessary that the subscribers to the agreement of association meet to elect officers as soon as possible, and thus provision is made in the statutes for calling a "first meeting". At this meeting a temporary clerk is elected and by-laws are adopted. In accordance with the provisions of the by-laws, the trustees, a president, and a permanent clerk and other officers are elected. The president-elect and a majority of the trustees elected at the first meeting sign and make oath to duplicate copies of the agreement of association the names of the subscribers and the name, residence, and post office address of each of the officers of the new organization, together with the date of the first meeting and successive adjournments thereof, if any. One copy of the agreement, etc., is sent to the Board of Bank Incorporation and the other, together with the records of the proposed corporation, to the Commissioner of Corporations and Taxation. If the Commissioner of

Corporations and Taxation finds that the statutes have been complied with satisfactorily, he endorses his approval on them. The approved articles are then filed with the Secretary of State who has them recorded after the payment of a fee of five dollars. Thereupon, he issues a certificate of incorporation.[37]

Certain aspects of this procedure for oganizing a mutual savings bank in Massachusetts warrant comment. It was stated that the would-be incorporators have to make application to the Board of Bank Incorporation for permission to incorporate a bank. This Board is a body whose sole function is to attend to the incorporation of banks. The Board must prevent undesirable citizens from incorporating a bank and to prevent the organization of a bank where an additional banking facilities would not benefit a community. When a town is served by too many banks it becomes difficult for any to make a profit, and the result is two or three weak banks instead of one strong one. (This factor is recognized by the Federal authorities also and even though a community has no National Bank, the Comptroller of the Currency refuses to allow the incorporation of a National Bank in a place where the community is already well served by a State institution, and the addition of a National bank would only serve to weaken the bank already established.) The National authorities always consult the State authorities regarding the establishment of a National bank.[38]

It was stated also that the State of Massachusetts requires that a public hearing be held subsequent to a three-week public

[37] Massachusetts General Laws, Chapter 168, Section 7
[38] "Banking Theory and Practice", Harr and Harris, McGraw-Hill, Page 29

notice of the intention to establish a bank in a certain place. This hearing is a recognition by the State authorities that there are people whose interests may be jeopardized by the incorporation of a new bank for a community where there is a bank or which is served by a branch institution. At this hearing the people so affected may appear and their contentions are considered carefully before the permission or the denial of permission to incorporate is given. Any complaints about the character of the incorporators may be expressed at such a hearing also. The interest of the depositors is foremost in the minds of the law makers; the depositors are being protected against exploitation.

Regulations Pertaining to Personnel and Directors of Banks

The care that must be exercised in the selection of the personnel of the bank may be demonstrated by an illustration from the Federal law pertaining to National banks. The Federal law provides: "Every director must during his whole term of service be a citizen of the United States and at least three-fourths of the directors must have resided in the state, territory, or district in which the association is located, or within fifty miles of the location of the office of the association, for at least one year immediately preceding their election, and must be residents of such State or within a fifty mile territory of the location of the association during their continuance in office. Every director must own in his own right shares of the capital stock of the association of which he is director, the aggregate par value of which shall not be less than $1000, unless

the capital of the bank shall not exceed $25,000 in which case he must own in his own right shares of such capital stock the aggregate par value of which shall not be less than $500. Any director who ceases to be owner of the required number of shares of the stock, or who becomes in any other manner disqualified, shall thereby vacate his place."[39]

The foregoing excerpt from the McFadden Bill of February 1927 shows the degree of care which must be exercised in making a selection of directors. The directors must be citizens and, therefore, subject to prosecution for violations of the law in the United States or State Court; in addition, they must be residents in a locality which is within a fifty mile radius of the location of the bank and, therefore, cannot very well evade responsibility for the management of the bank because they are absent from its locality. When a director is near his bank, he can see to its conduct more satisfactorily. Finally, this Act states that he must be financially interested in the institution for which he is a director. This provision assures that a director will not fail to see to the proper management of the bank because he has his own money at stake in the venture.

"The Supreme Court of the United States has held that directors of a National bank must exercise reasonable care and prudence in the administration of a bank, and this includes something more than officiating as figure heads. They are entitled under the law to commit the banking business, as defined, to the duly authorized officers; but this does not absolve them from

[39] "Banking Theory and Practice", Harr and Harris, McGraw-Hill, Page 29 (McFadden Bill, Act of February 25, 1927, Section 17)

the duty of reasonable supervision, nor ought they to be permitted to be shielded from liability because of want of knowledge of wrongdoing if that ignorance is the result of gross inattention."[40]

The directors of a national bank are informed of their responsibilities and the penalties which may result from negligence in performing their duty. Furthermore, the director is subject to financial assessments under the double liability feature of the stock of his national bank. (See Page 56)

The above provision states that the directors may delegate the business of banking to the personnel of the bank. However, the law is careful to state that a commission of authority to another is not a removal of responsibility.

The conduct of the banking business by the personnel of a National bank is carefully outlined in statutes which pertain to such affairs and here, as in the organization of a bank or the selection of directors, the law protects the depositor insofar as it can do so against loss of his money. However, no law can give a man intelligence or make him completely honest. It can help him to avoid mistakes.

The Federal authorities who supervise the National banks of the United States declare the following in regard to the personnel of the bank: The examiner who is looking into the establishment of a new bank will investigate (1) "The general character and experience of the organizers and of the proposed officers of the new bank; (2) the adequacy of existing banking facilities, and

[40] "Banking Theory and Practice", Harr and Harris, McGraw-Hill, Page 29 (McFadden Bill, Act of February 25, 1927, Section 17)

the need of further banking capital; (3) the outlook for the growth and the development of the town or city in which the bank is located; (4) the methods and banking practices of the existing banks or bank, the interest rates which they charge to customers, and the character of the service which as quasi-public institutions they are rendering to the community; (5) the reasonable prospects for success of the new bank if efficiently managed."[41]

Regulation of Capital Requirements

In regard to the capital requirements which must be met before the business of banking may be commenced, the statutes regulating the national banks state the following: "National banks with a minimum capital of $25,000 may be organized in any place, the population of which does not exceed 3,000; with a minimum capital of $50,000 in any place, the population of which does not exceed 6,000; with a minimum capital of $100,000 in any place, the population of which does not exceed 50,000; and with a minimum capital of $200,000 in cities with a population of over 50,000."[42]

These capital requirements prevent people who have no financial responsibility from entering the banking business. Furthermore, when the Federal Government specifies that National banks located in communities having population of a given size must have a minimum capital of a certain amount, it is merely a recognition that the capital of a bank should have a definite relationship to the amount of deposit liability that a bank may be expected to have. In other words there should be an investment

41 "Banking Theory and Practice", Harr and Harris, McGraw-Hill, Page 27 (Instructions of the Comptroller of the Currency Relative to the Organization and Powers of a National Bank 1926)

42 Ibid.

of owners' capital sufficiently large that the sum of this capital, plus the assessments that may be levied against it (double liability) together with the investments made by the bank, will be sufficient to pay off depositors in full in the event of a failure of the bank. It is inconceivable that all the investments of a bank should be bad at the same time and, therefore, even though a bank failed to remain solvent, the depositors should derive an appreciable portion of their money from the liquidation or assumption of the bank's portfolio.

The State of Texas was the first state to attempt to establish an arithmetical relationship between deposits and the capital of a bank. The relationship was established by the laws of Texas as follows:

Capital	Deposit Liability
$ 10,000	Five Times Capital and Surplus
10,000 - 20,000	Six " " " "
20,000 - 40,000	Seven " " " "
40,000 - 75,000	Eight " " " "
75,000 - 100,000	Nine " " " "
100,000 or over	Ten " " " "

The Texas law provided in addition that if these deposit liability limitations were exceeded, the bank must increase its capital twenty-five per cent within sixty days.[43]

At least fifty per cent of the capital stock of a national bank must be paid in before a national bank may commence business

[43] "The Guaranty of Bank Deposits", Thomas B. Robb, Houghton-Mifflin Company, 1921, -- Page 15

and the remaining capital must be completely paid in within six months from the time of beginning business.[44] These requirements afford protection and safety to the depositor also. There was a time when banks could organize by meeting very small capital requirements and, moreover, practically no provisions were made for the payment of this capital to the bank. As a result, the capital of many small banks in the middle west in the 1840's and 1850's consisted of mere promises to pay the organizers, and these proved worthless many times when the banks failed.

Regulations Pertaining to Bank Management

The degree of care that must be exercised in the operation of a bank is also provided for by statutory enactments. It is recognized that many organizers of banks have had little or no experience in managing financial institutions so the law attempts to set up guide posts and restrictions for the protection of bank depositors. For example, the Massachusetts laws pertaining to the investments which may be made by the mutual savings banks is an excellent illustration of the restriction which may be placed upon the use of funds.[45] The chart on Page 48 serves to illustrate the diversity of investment which must be achieved. In the case of each investment the savings bank may not place more than a certain percentage of its assets in the particular security or property. No savings bank in Massachusetts may invest more than 70% of its deposits in first mortgages on real estate, and no mortgage may exceed 60% of the value of improved property, nor more than 40% of the value of unimproved property.[46]

[44] "Banking Theory and Practice", Harr and Harris, McGraw-Hill, Page 28

[45] Massachusetts General Laws, Chapter 168, Section 54

[46] Ibid.

INVESTMENTS
LEGAL FOR
MUTUAL SAVINGS BANKS
IN THE COMMONWEALTH OF MASSACHUSETTS

REAL ESTATE
BANKING ROOMS
FIRST MORTGAGES ON REAL ESTATE.
REAL ESTATE ACQUIRED BY FORECLOSURE.

PUBLIC FUNDS
BONDS OF THE UNITED STATES. BONDS OF THE COMMONWEALTH OF MASSACHUSETTS. CERTAIN BONDS OF CITIES, TOWNS AND INCORPORATED DISTRICTS OF THE COMM. BONDS OF THE N.E. STATES CERTAIN BONDS OF THE N.E. STATES AND STATES OF THE U.S. AND THEIR SUBDIVISIONS.

RAIL ROAD BONDS
BONDS OF MASS. R.R. CORP, BONDS OF R.R. CORP. OF THE N.E. STATES.
OTHER R.R. BONDS;
R.R. EQUIPMENT BONDS
CERTAIN GUARANTEED R.R. BONDS. BONDS
REFUNDING AND UNDERLYING R.R. MTGE. BONDS.

PUBLIC UTILITY BONDS
BONDS OF TEL. & TEL. CO'S.
BONDS OF STREET RWYS.
BONDS OF GAS COMPANIES.
BONDS OF WATER COS.
BONDS OF ELECT. LIGHT AND POWER COMPANIES.
BONDS OF OTHER PUBLIC SERVICE CORPORATIONS.

SECURITIES
STOCK OF TRUST COS. AND NATIONAL BANKS OF THE COMMONWEALTH.
FARM LOAN MTGE. BONDS
SECURITIES ACQUIRED IN SETTLEMENT OF INDEBTEDNESS.
CERTAIN INVESTMENTS LEGAL, PRIOR TO JUNE, 1908.
HOME LOAN BANK STOCK.

'DEPOSITS
CLUB DEPOSITS
SURPLUS, GUARANTY FUND
UNDIVIDED PROFITS
SAVINGS INSURANCE
DEPOSITS

SECURED NOTES
NOTES SECURED BY PERSONAL PROPERTY.
NOTES SECURED BY COLLATERAL.
NOTES SECURED BY PASS BOOKS.
NOTES OF CORPORATIONS ENDORSED BY SURETY COMPANIES AND COMMISSION HOUSES.
NOTES SECURED BY PROOFS OF CLAIMS UPON DEPOSITS IN CERTAIN CLOSED BANKS.

UNSECURED NOTES
NOTES OF THREE CITIZENS
NOTES OF R.R. CORPS.
NOTES OF PUBLIC SERVICE CORPORATIONS.

ACCEPTANCES
DRAFTS ACCEPTED BY TRUST COMPANIES OF MASSACHUSETTS.
DRAFTS ACCEPTED BY NATIONAL BANKS. LOCATED IN MASS

DEPOSITS
DEPOSITS IN TRUST COMPANIES OF MASS.
DEPOSITS IN NATIONAL BANKS LOCATED IN MASSACHUSETTS
DEPOSIT WITH THE CENTRAL MUTUAL SAVINGS FUNDS.

SURPLUS, ETC.
SURPLUS:—
INCLUDING GUARANTY FUND, AND
UNDIVIDED PROFITS

DIVERSITY — PROTECTION

MUTUAL SAVINGS BANKS
STABILITY
OF MASSACHUSETTS

LIQUIDITY — SAFETY

The degree of care which is given to the depositor in the mutual savings bank in Massachusetts may be illustrated by the provisions which pertain to the investment of funds in railroad securities.[47] A savings bank may invest in the bonds or notes of a railroad corporation incorporated in the Commonwealth and operated in whole or in part within the boundaries of the Commonwealth which has paid in cash dividends to the amount equal to four per cent of all its capital stock in each of five fiscal years prior to the purchase of the bond or note. Secondly, a savings bank may invest in the assumed bonds of a railroad corporation incorporated in any of the New England States, at least one half of which railroad is located in these states. Such bonds must be a first lien and such corporation must have paid in cash dividends equal to four per cent of its outstanding capital stock over the preceding five-year period. In addition, the bonds of such corporations are not deemed to be a legal investment unless during each fiscal year preceding the date of investment the corporation shall have paid dividends on its capital stock equal to one-third of the total amount of interest paid on all its direct and assumed funded indebtedness. Thirdly, the mutual banks of Massachusetts may invest in the bonds of railroads in the states of the United States provided: (1) that either such railroad owns 500 or more miles of standard gauge track excluding sidings or portrays gross earnings of not less than $15,000,000; (2) that such railroad has paid all the principal and interest due on all its bonds issued previously; (3)

[47] Massachusetts General Laws, Chapter 168, Section 54

that such railroad has paid in cash dividends an amount equal to four per cent of its outstanding capital stock; (4) that such railroad has earned from the operation of its own system (including income from the sale of coal from mines it owns or controls, or railroads leased and operated or controlled and operated) gross earnings five times the interest due on its outstanding indebtedness, rental charges, interest on all lines operated and controlled by this railroad whose securities are being investigated.

There are many more provisions regarding the purchase of railroad securities, but the regulations stated are sufficient to demonstrate the adequacy of the law and the protection afforded the depositor. One striking requirement is that which provides that "a railroad must have paid cash dividends of not less than four per cent each year over a period of four or five years, depending upon where the railroad is located. Anyone who is acquainted with the payment of interest and dividends knows that interest must be paid before dividends and that railroads must pay the interest upon several classes of bonds such as first and second mortgages, junior liens, etc., and then pay dividends upon the preferred stock before any dividends may be declared upon the common. The bank is buying only those obligations which receive first consideration. Furthermore, a railroad might well pay interest every year for a number of years and still fail to pay any dividends. But the Massachusetts law says that common stock dividends (the last to be paid), and to an amount of not

less than four per cent of the capital stock outstanding, must have been paid for four or five consecutive years. This means that if a railroad corporation fails to pay a quarterly dividend only once during a four-year period, its securities may not be bought by a Massachusetts savings bank. Any depositor can ask for little more protection for his money than such requirements as those just stated.

Regulations Pertaining to Bank Supervision

In most states the supervision of banks is delegated to a bank commissioner, superintendent, or bank commission. These officials are delegated certain specific power by the respective legislatures of the states. The appointment or election of an official whose sole function it is to supervise the conduct of banks, check up on the manner in which they are complying with the law, and in the event that circumstances warrant take over the operation of banks that seem to be insolvent, is a recognition of the factor that the average citizen is not capable of judging the soundness of a bank nor the integrity of its management and, therefore, it is essential for that individual to rely upon the state to protect his or her interest in the sound operation of banking institutions.

In Massachusetts the Commissioner of Banks is delegated specific powers which enable him to keep close watch over all institutions carrying on a banking business and, when the occasion so demands, he is empowered to take action in behalf of the citizens of the Commonwealth.

The Commissioner of Banks has these powers:[48] (1) Approve the by-laws of the bank or banks; this power enables him to prevent bank officials from overstepping the authority delegated them by statute. (2) The Commissioner may prescribe forms and records for the banks; this power enables the Commissioner to simplify his supervision of banks by standardizing their records, accounts, and accounting procedures, and it also prevents the possibility of unnecessary expense in keeping the records of the banks. (3) The Commissioner may compel reports from banks; this is an essential power if he is to make periodic checks upon the financial status of the state banks. (4) He can remove officers for reasons; this power makes it possible for the state to take action against incapable and dishonest men who are not acting in the interest of the depositor. (5) The Commissioner may supervise the payment of dividends; another power which makes it less likely that a bank will declare dividends to stockholders (or depositors in the case of the mutual savings banks) when such funds should be placed aside to build adequate reserves and surplus funds which are so essential to the protection of depositors. (6) The Commissioner may compel the verification of passbooks; this power is essential if protection is to be given the depositors. It is possible for a bank clerk to have less money credited to the account of a depositor on the records of the bank than is credited in the depositor's pass-book. The writer knows of an instance where a clerk kept a double set of cards. On one set he recorded the

48 Massachusetts General Laws, Chapter 167

proper amount of money, and this card only corresponded to the pass-book balance. On another card in the bank's files he recorded a much smaller sum. He was thus able to take cash from the bank and speculate. This system worked only so long as he waited upon the customer, and so long as the customer did not demand the full payment of his deposit account. It is not at all an unheard of thing for bank employees to "borrow" a sum of money from an account that seems to be relatively inactive. (7) The Commissioner of Banks is empowered to make periodic examinations of banks at the expense of the bank being examined. This is a power which the Commissioner must exercise to determine the solvency of a bank as well as the degree to which the bank is obeying the law. (The Commissioner is required to examine every bank at least once in a period of one year.)[49] (8) The Commissioner of Banks has the authority to pass upon the establishment of branches by a bank, and (9) the amount of money that is being expended for buildings. This latter power is essential to prevent the use of too large a proportion of the bank's assets for building purposes. Many bankers would defeat the possibility of profitable operation by such a procedure. Furthermore, the bank must provide adequate facilities for the protection of its cash in the vaults and its investments. (10) The Commissioner must rule upon the legality of certain investments, and (11) he must take over insolvent banks. The last power is to prevent the wasting away of assets that should be used to repay the depositors and creditors of the bank.

[49] Massachusetts General Laws, Chapter 167

Regulations Pertaining to Bank Liquidations

The interest of the depositor is given final recognition in the statutory provisions regarding the liquidation of banks and the taking over of insolvent banks by the Commissioner of Banks. The statutory provisions in Massachusetts regarding the liquidation of banks are: A savings bank of the Commonwealth is not allowed to liquidate its affairs without having made an attempt to enter into negotiations with other savings banks located within a twenty-five mile radius with a view to consolidation or merger. If no consolidation or merger can be arranged and if the Commissioner of Banks is satisfied that the savings bank desiring to liquidate has given at least thirty days notice to each other savings bank, the bank may be liquidated. This may be done only in the event that the liquidation is authorized by two-thirds vote of its incorporators at a meeting especially called to consider the subject, and that prior to such vote the Commissioner shall have approved in writing the proposed liquidation as being in the interest of the depositors.

The liquidation of the bank may be conducted by a committee of three directors elected for the purpose under such rules as the Commissioner may prescribe.

One cannot examine the statutory provisions regarding the organization, conduct, and supervision of banks without being impressed with the degree of care which those engaged in the banking business must exercise in the interest of depositors. The fundamental reason back of practically all legislation which

pertains to banking is to afford greater protection to the depositor whose ability to select his bank for its goodness and the quality of its management is greatly impaired by his ignorance about banking matters.

In addition to the foregoing statutory provisions which give the depositor a good measure of protection, there are many other protective devices which could be cited to supplement the illustrations given, but the provisions stated serve to demonstrate the protection afforded the depositor. However, a discussion of statutory provisions which are designed to safeguard the public's stake in the banking business cannot overlook the matters of "double liability of bank stock" and "reserves against deposits".

Double Liability of Bank Stock

Until recently practically all the bank stock which was sold to those subscribing to the capital of a bank through the purchase of its stock had a double liability clause.

In purchasing the capital stock of an ordinary corporation one is liable for the debts of the corporation to the extent of the face (par) value of the stock only. That is, it is possible to lose one's entire investment in that particular business through bad management of its affairs, and the liability in the venture ceases there. However, in the case of one who purchases bank stock, provided it contained the double liability feature, the holder is liable not only to the creditors of the bank to the amount of his investment, but he is subject to an assessment

of a sum equal to the par value of the stock.[50] This feature is incorporated in bank stock to give the depositors a margin of protection against loss of deposits in the bank in the event that the bank becomes insolvent. Furthermore, it is intended to discourage those persons who are not financially responsible from becoming stockholders or owners of a bank. The banks whose stock carries the double liability feature are the National banks, stock savings banks, and trust companies.

Legal Reserves Against Deposits

In the establishment of legal reserves against deposits, the interest of the law making bodies in the safety of the deposits entrusted to a bank is again recognized. The legal reserve is a banking principle which is peculiar to this country. The legal reserve today is not regarded as being so important as a guaranty for the repayment of deposits, as a means of restricting the amount of deposits which a bank might receive and thus preventing the bank from building a deposit liability out of proportion to the size of the bank and sound administration.

To be sure bankers should always keep a reserve of cash on hand, and this should be used to satisfy attempted runs on the bank or to instill public confidence in the ability of the bank to pay its obligations. It is this latter function that is performed by the legal reserve. It is a kind of bluff. A bank has the reserve and it must be so large regardless of the bank's location, size, type of business, etc. Furthermore, whenever the bank has occasion to use the reserve in an emergency it may

[50] Massachusetts General Laws, Chapter 172, Section 24

not do so. When a bank's legal reserve is below the minimum specified by law, the bank is violating the banking laws of the state and is subject to being closed.

In addition, it must be pointed out that the legal reserve can be a serious handicap to a bank in that it can tie up funds in idle reserves which should be used to earn income for the bank, and the amount involved in the reserve may be large enough to determine whether or not the bank is able to earn a profit.

Under the old National Banking System, the National banks of the country were divided into three classes[51]: (1) Central Reserve City Banks, (2) Reserve City Banks, and (3) other banks. The Central Reserve City Banks had to keep a reserve of twenty-five per cent against all deposits, all of which had to be in the bank's own vault; the Reserve City Banks had to have a reserve against deposits of twenty-five per cent also, but one-half of this could be deposited in a Central Reserve City bank. The other banks of the country had to have a reserve of fifteen per cent, of which three-fifths or nine per cent could be deposited in a Central Reserve City bank or Reserve City bank. With the establishment of the Federal Reserve system, the banks of the country were classified in the same manner, but the reserves that had to be maintained against deposits were changed to thirteen per cent for Central Reserve City banks, ten per cent for Reserve City banks, and seven per cent for other banks. There could be no depositing of reserves in other banks, and all reserves had to be kept in the Federal Reserve bank of the

51 "Banking", F. A. Bradford, Longmans Green and Company, Pages 78-79

district where the bank was located.[52]

In the States, the system of keeping reserves was similar. For example, in Massachusetts the trust companies located within a three-mile radius of the State house have to keep a reserve of twenty-five per cent of the total deposits received, whereas the trust companies outside of the three-mile radius have to keep a reserve of only fifteen per cent of deposits. Certain trust companies are designated by the Commissioner of Banks to receive the reserve of other trust companies on deposit.

Regardless of the percentage of reserve which must be kept against the deposits of a bank, the same idea of affording protection to the depositor is present. The amount of the reserve that must be kept prevents the bank from receiving an excessive amount of deposits.[53] In the case of the commercial bank where the majority of deposits arise out of loans, the amount of the reserve that must be maintained restricts the amount of lending of the bank.

Primary and Secondary Reserves

Whenever the public is given any cause for doubting the liquidity of a bank, the reaction is likely to be a "run" on the bank by those who have deposits in the institution whose soundness is questioned. It is very easy for people who do not understand the business of banking to misinterpret some conduct of the bank or some statement of an official and thereby start a run that will force the bank to close its doors and ultimately liquidate its investments to pay depositors. In such cases

[52] "Banking", F. A. Bradford, Longmans Green and Company, Page 266

[53] "Banking Theory and Practice", Harr and Harris, McGraw-Hill, Pages 128-132

there is usually considerable shrinkage in the value of the assets, and the result is unnecessary loss to the depositors.

In order to avoid these unfortunate occurrences, which every bank must be ready to confront, the bankers have developed a ratio of primary reserves to secondary reserves. A primary reserve means funds of the bank that are either in the form of cash in vault or in investments so relatively liquid that the bank can obtain cash for them in a short time. These investments that may be counted as part of the primary reserve include: (1) Commercial paper that meets the credit and legal requirements of the Federal Reserve System and which, therefore, may be converted into cash by discounting them at the Federal Reserve Bank; (2) demand deposits at the Federal Reserve Bank which may be obtained in cash for the asking; (3) bankers' acceptances which have a ready market and may be sold for cash, and demand deposits with other banks which may be counted upon to produce ready cash.[54]

Secondary reserves consist of such things as high grade commercial paper called bonds[55], Government bonds, etc., and these are considered legitimate short term investments for a commercial bank, but are not so liquid as are the primary reserves.

The proper ratios of primary reserves to secondary reserves cannot be determined except in the case of a given bank when one knows its business, its demands, its size, and its peculiar problems. However, it is important to note that the banks themselves

[54] "Banking Theory and Practice", Harr and Harris, McGraw-Hill, Page 127

[55] Ibid.

are alive to providing this protection to their depositors. The bank which keeps itself in a position to meet unusual demands and circumstances is serving the needs of its depositors.[56]

There is no legislation on the proper relationship between primary and secondary reserves, but the factors to be considered in determining the right ratio for the individual bank are made available to banks through the American Banker's Association.

[56] "Banking Theory and Practice", Harr and Harris, McGraw-Hill, Page 126

PART III

PART III

HISTORY OF BANK DEPOSIT GUARANTY IN THE UNITED STATES

Introduction

It has been shown already that the legislators of the various state governments as well as those in Washington have recognized the necessity of safeguarding the public's money in banks and banking institutions, and have placed certain safeguards and limitations upon the operation and conduct of the various banking systems created. These laws which regulate banks, define their powers, limit their investments, etc., are designed to assure greater confidence in the banks on the part of the public and at the same time to prevent the bankers from carrying on practices of a questionable nature and which might result in economic chaos and loss of the savings of innocent people.

It was pointed out also that a desire to assure even greater public confidence in the banking system of the country resulted in the creation of bank deposit guaranty schemes. During the last century there have been several schemes proposed. All of them have been similar in purpose, but different in certain details of their operation. It will be helpful to a better understanding of the subject of "The Guaranty of Bank Deposits" to review briefly these various guaranty programs. It is not intended that we should examine in detail all the attempts that have been made in this country, but only those of significance in contributing ideas for the development of any guaranty program.

The first attempt in the United States to guarantee the payment of creditors of a bank was that of New York State in 1829. This program was known as "The New York Safety Fund".

The New York Safety Fund System was the first attempt at bank deposit guaranty. After the failure of the safety fund in New York State there were no significant attempts at guaranteeing the payment of bank depositors in failed banks until the State of Oklahoma passed a law providing for the guaranty of bank deposits on a state-wide basis shortly after the admission of Oklahoma to the Union as a State.

It is of real value to trace the history of the bank deposit guaranty scheme that Oklahoma put into operation, as well as plans adopted by other states that followed Oklahoma's example. In these are found the principles which helped formulate the Federal Deposit Insurance Corporation in 1932. The experience of these deposit guaranty plans, their popularity with the banks and the public, their influence upon the growth of deposits in state and national banks, and, finally, their success are all of importance in throwing light upon the future life of the recent Federal law.

Chapter One

THE NEW YORK SAFETY FUND [57]

Introduction

The place of the New York Safety Fund in the guaranty of bank deposits is a peculiar one. Certain banking practices in vogue at the time that the Safety Fund was established and some of the evils of which it was designed to remedy, brought the Fund into existence. It was designed to secure the circulation of the banks of the state of New York and through a technicality in the law, it became a deposit guaranty system, and this outcome of the law caused its failure thirty-seven years later.

In order to appreciate the significane of the Safety Fund system, it is desirable to compare the commercial banking practices at the time of the enactment of the Safety Fund legislation with practices in commercial banking today.

When one borrows money from a commercial bank today, it is customary to accept a "credit to account" at the bank against which checks may be drawn. The conveniences of these checks have been pointed out. Furthermore, when a man receives the proceeds of a loan at a bank in the form of cash in hand rather than as a credit to his account, there is no question about the exchange value of the money because the Government has provided adequate safeguards for its universal acceptance such as redemption privileges, collateral security, etc.

However, in the first half of the eighteenth century the borrower from a commercial bank was not able to obtain a credit

---

[57] "History of Banking in the United States", John Jay Knox, Bradford-Rhodes and Company, (1900), -- Pages 399-413

to account. The bank gave him its own bank notes in exchange for his note or draft. Not only did this type of currency lack all the conveniences that the modern check currency possesses, but because of overissue and lack of confidence in the banks, the notes were not always accepted at face value, and there was a refusal on the part of the public to accept the notes of the closed bank at all. This refusal to accept the bank currency proved embarrassing for innocent holders of these notes, and often caused business no little amount of inconvenience. These factors, among others, gave rise to the so-called Safety Fund System in New York. It was no less important to have public confidence in the notes of these banks, which constituted the medium of exchange of the time, than it is important today to have public confidence in the safety of the commercial deposits which are the basis for the great volume of check currency of today.

In a sense, therefore, the guaranty of the bank circulation a century ago was a security provided the public which is comparable to the guaranty of the commericial bank deposits of today.

The Safety Fund

It was not until 1829 that the New York Safety Fund plan began to take shape. As a result of the approach of a time when many of the charters of the banks in the State of New York would expire, certain members of the State Legislature seized upon the time as opportune to put an end to many dishonest and

undesirable practices which had existed in the banking world prior to this time. In reviewing the banking situation it was stated by one Mr. Forman[58] in a letter to Governor Van Buren of New York (this letter was enclosed in his message to the New York Legislature pertaining to the banking situation) that (1) existing banks were organized without adequate capital and were managed dishonestly; (2) banks that were organized honestly were often bought by swindlers who plundered good assets and sold fictitious stock to the public; and (3) there was no control upon the issue of circulation which caused as much financial disturbance by being suddenly contracted in amount as by being suddenly and excessively expanded. Mr. Forman argued "that the loss resulting from solvent banks due to injudicious management even exceeded those incurred by failures"[59]; and in substantiation of this argument he stated that: (1) The proper proportion of circulating medium is intimately connected with the products and commodities of a country, (2) paper that is redeemable in coin is as good as coin itself, and (3) an undue issue of paper currency has the effect of increasing prices. In elaborating upon this third point of consideration, Mr. Forman stated that when prices are increased as a result of there being too much paper money in circulation, there is no profit in exporting so that the domestic market becomes glutted and stagnation occurs. This stagnation makes less need for the circulating notes, and they are returned to the banks for redemption. Banks press their debtors, and prices fall as everyone is anxious to sell. When the prices

58 "History of Banking in the United States", John Jay Knox, Bradford-Rhodes and Company (1900), Page 400

59 Ibid., Page 401

drop, exporting begins and banks again put out excessive issues, and the same cycle is repeated.

As a remedy for these evils, it was suggested that legislation be passed to accomplish the following[60]: (1) Insure the payment of capital; (2) limit the loans and discounts; (3) prevent the issue of bills other than those payable on demand; (4) prevent speculation by bank officers in the depreciation of their paper currency; (5) prevent the transfer of assets to preferred creditors in anticipation of insolvency.

It was proposed in addition that the banks should be required to secure the safety of their circulation. In support of this proposal it was stated that the banks had the sole right to issue and take profits from the issuing of circulation and, therefore, the banks should guarantee the currency.

As a means of accomplishing this guaranty of the circulation it was proposed that funds be raised by annual assessments of all banks according to their capital to be applied to the payment of the debts of such banks as shall fail. In addition, it was proposed that whenever the fund became diminished, it should be brought up by further contributions on the part of the banks. In order to insure the functioning of the plan it was proposed that the state should refuse to incorporate additional banks unless they came under the proposed scheme for insuring the safety of the circulation. It was also provided that no bank should be incorporated until the Bank Commissioner certified to the Secretary of State that the capital stock was actually

60 "History of Banking in the United States", John Jay Knox, Bradford-Rhodes and Company, (1900), Page 401

paid in.

When the Safety Fund plan actually became law, it was known as "Judge Paige's Bill". Although the origination of the ideas incorporated in the Bill was attributed to various people, including Mr. Forman and another member of the New York Legislature, Abijah Mann, the latter claimed that he obtained the idea in conversations with a Mr. Benton in regard to English Joint Stock Banks.

On April 2, 1829, the New York Safety Fund became law.[61] The law provided that every bank created subsequent to its passage must contribute to a common fund a sum equal to one-half of one per cent of its capital stock paid in, the payments to be continued until every corporation had contributed to an amount equal to three per cent of its capital stock.

It was provided that the Fund should be in charge of the Comptroller and Treasurer of the State, the former being instructed to invest the Fund and from the income derived thereby to pay the expenses of the Bank Commissioners of the State of New York. When the income derived from the investment of the Fund was more than sufficient to pay the expenses of the Commissioners, the Comptroller was to return the remainder to the contributing banks. Furthermore, it was provided that when the Fund was reduced by payments on account of insolvency, the banks were to be required to contribute to the Fund until it reached the three per cent limit.

Among other provisions of the Act of April 2nd, it was

61 "History of Banking in the United States", John Jay Knox, Bradford-Rhodes and Company, (1900), Page 404

provided that each bank should be examined once in each four months, and no new bank could commence business until the payments of the capital had been proven to the satisfaction of the three Bank Commissioners provided for in the Bill. It was also provided that any three corporations could request the special examination of any bank. In regard to the amount of notes that any bank might issue, it was provided that banks could issue notes only to double the amount of capital of the bank, and loans could not exceed two and one-half times the amount of capital of the bank. Finally, it was provided that when a bank became insolvent, the Chancellor of the State must determine the amount of money to be paid from the Safety Fund.

The Safety Fund in Operation[62]

When the Safety Fund got under way there was such a number of applications to incorporate new banks under the Safety Fund that state authorities were faced with the problem of determining how many banks could be established and considered to be prudent investments. In addition, the stock of the new banks was eagerly sought after both locally and out of the State. In 1832 there were fifty-two banks in operation under the safety system, while there were twelve banks operating outside of the system. It was a common opinion at this time that all the safety-fund banks were sound, even though it was recognized that there had been a great increase in capital stock and circulation. By 1835 the number of safety-fund banks had increased to seventy-six, and by 1841 there were ninety banks under the Safety Fund

62 "History of Banking in the United States", John Jay Knox, Bradford-Rhodes and Company, (1900), Page 405

system.

A letter written by Mr. Forman presenting his proposed Safety Fund System stated that the Safety Fund should be used to pay "the debts of the banks" and it was this phrase that caused the disaster of the system. By this phrase he meant that the Fund should be used to redeem the circulating capital of the banks, and not to secure other creditors of the bank. This phrase was incorporated in the Safety Fund Act and the error was soon discovered by many unscrupulous bank managers who contracted debts in the name of their respective banks for the "emolument" of the bank managers.

In "The History of Banking in the United States" by John Jay Knox it is stated: "In 1842 an act was passed devoting the safety fund exclusively to the redemption of circulating notes; but within the six months previous to the passage of this law, six banks with a circulation of $1,408,000 had failed and injunctions were obtained by the creditors of these institutions to prevent any payments from the fund to redeem the circulation of banks subsequently becoming insolvent until all the debts of banks failing prior to 1842 had been paid. The act of 1837 authorized immediate redemption of bills but required that one-third of the safety fund was to be reserved for 'debts'."[63]

It seemed quite contrary to the intentions of those who were instrumental in the establishment of the safety fund that it should be used for purposes other than a mere protection for the holders of bank notes, i.e. that it became a deposit guaranty

[63] "History of Banking in the United States", John Jay Knox, Bradford-Rhodes and Company, (1900), Page 409

system, the legality of which was upheld by a technical error in the act of the legislature which created the fund. Mr. Millard Fillmore who was Comptroller of the State of New York in 1848 stated: "Since 1829 the contributions to the fund had been $1,876,063, the whole circulation redeemed from the insolvent banks was $1,548,558, leaving a surplus of $327,505 which with the amount obtained for the six per cent State Stock had been swallowed up to meet other debts of the institutions. 'It is, therefore, apparent that the safety fund would have proved ample indemnity to the bill holder had it not applied to the payment of other debts of the bank than those due for circulation'." Mr. Fillmore thought that the safety fund was a proper device for securing bank circulation, but he saw no reason why the fund should be created for the purpose of securing depositors and other creditors.[64]

In 1848 the Comptroller's report stated that the safety fund had long since been exhausted, and that it had been necessary to mortgage future contributions to it by the issue under an act of 1845 of $900,828.47 of six per cent. State bonds to pay the debts of banks which had failed and the obligations of which exceeded the amount of the safety fund.[65]

The safety fund system was finally terminated in 1866 when the last of the charters of the banks incorporated under its plan expired. In that year the legislature passed an act stating that all the claims due from the safety fund should be paid and the funds remaining after the discharge of these debts should

64 "History of Banking in the United States", John Jay Knox, Bradford-Rhodes and Company, (1900), Pages 412-413

65 Ibid., Page 412

be paid into the State Treasury.

Insurance of Deposits and Circulation

The New York Legislature regarded note issues of the commercial banks and the deposits held by the banks as being distinct in nature. There seemed to be a feeling that the insurance of bank deposits and the insurance of bank circulation had no relationship. It was held to be essential to insure bank notes while the safety of deposits were a matter for the individual and the bank to settle to their own satisfaction.

In fact, the distinction between bank deposits and bank notes which the New York Legislature made has no real foundation. The two are essentially the same.

Irving Fisher states: "Beside lending deposit rights, banks also lend their own notes called 'bank notes', and the principle governing bank notes is the same as the principle governing deposit rights. The holder simply gets a pocketful of bank notes instead of a credit to his bank account. The bank must always be ready to pay, on demand, either the note holders, i.e. to 'redeem its notes', or the depositors, and in either case the bank exchanges a promise for a promise."[66]

The legislators base their arguments in favor of the protection of only bank notes upon the grounds that the people of small means have few bank accounts and have to rely upon bank notes for circulating media and, therefore, since these people cannot judge the soundness of a bank, the State must throw safeguards around the notes of banks.[67] Furthermore, it is held that

66 "Elementary Principles of Economics", Irving Fisher, Macmillan (1928), Pages 170-171

67 "The Guaranty of Bank Deposits", Thomas B. Robb, Houghton-Mifflin (1920), Pages 15-17

the depositor can select his bank and assure himself of a measure of protection. In other words, the legislator regards the note holder as an involuntary creditor, while it regards the depositor as a voluntary creditor. Finally, there is the argument that because checks are presented for payment at once, while bank notes stay in circulation for some time, that the bank may grow careless about providing redemption of its notes.

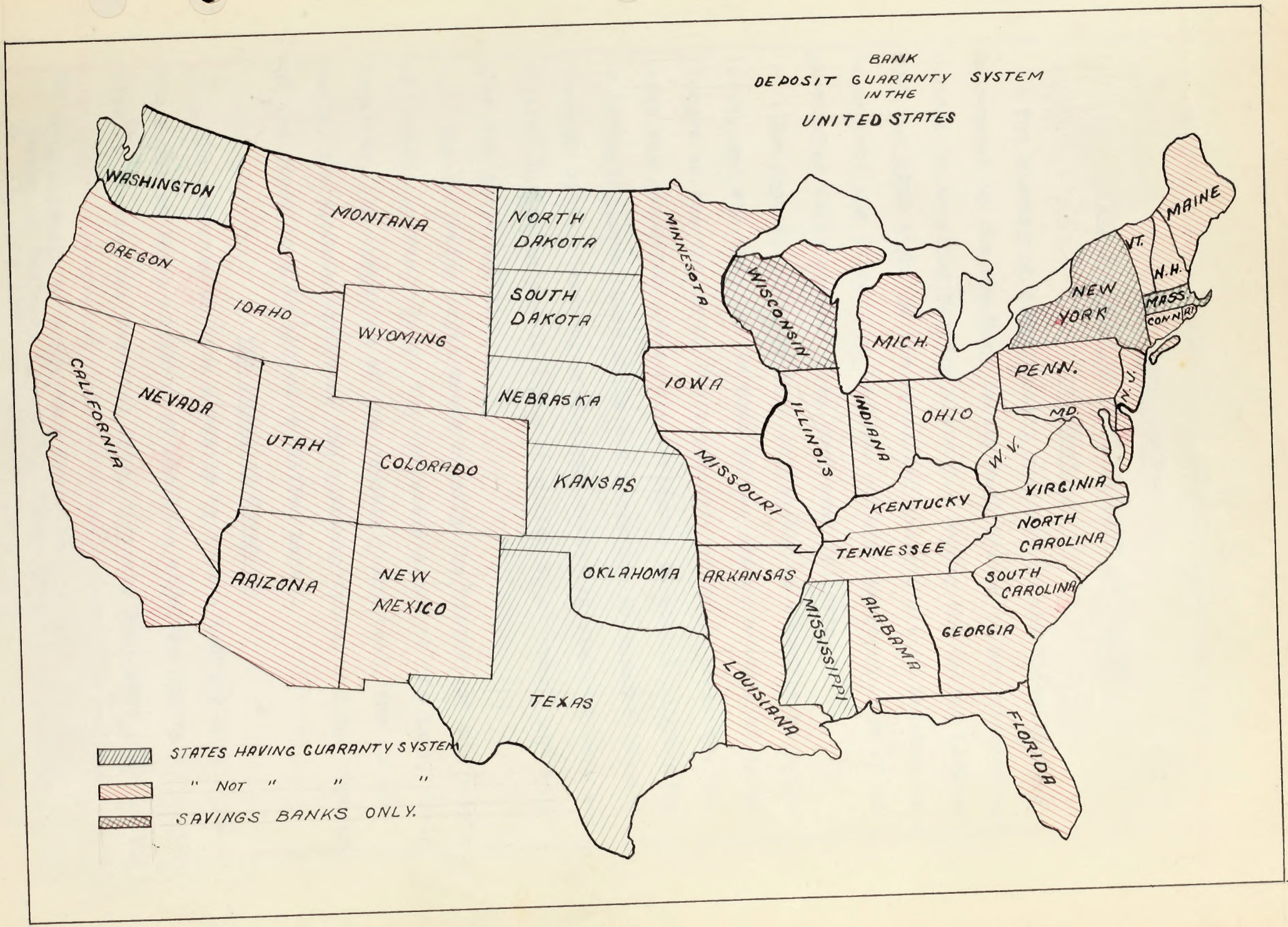
To the bank it is immaterial whether it lends bank notes or bank credit. And since the bank credit came to be recognized as being more convenient in a business world growing more complex, the check currency has superceded the bank note currency.

It can be stated, then, that even though there was a feeling on the part of many that the payment of all debts by the safety fund, including deposits, brought failure to the safety fund system, the guaranty of the bank notes alone was security of bank credit as is a deposit guaranty system that secures bank credit.

The failure of the safety fund cannot be used as evidence against the likelihood of success of a deposit guaranty system. Even though the law became a deposit guaranty system, the intent of the law was to accomplish the security of bank cirulation and not to guarantee the payment of deposits of failed banks. It is quite possible that the safety fund would have been a successful device for securing bank notes if it had not been for the mistake in wording the law establishing it which placed a burden upon the system which it was not intended to carry. Unfortunately

the heaviest failures took place before the Legislature made the change by which only the circulation of bank notes were to be redeemed under the safety fund. During the thirty-seven years of its existence from 1829 to 1866, the contributions to the fund were ample to redeem the notes of insolvent institutions.[68] One must recognize that the deposits of failed banks that were indemnified under the safety fund were different from the commercial deposits which are secured today; they were not bank credit as are today's deposits. One can readily see how the payment of these deposits brought ruin to the system, but it must not be overlooked that there is a similar significance in the guaranty of bank notes a century ago and the guaranty of the commercial deposits of today.

[68] "History of Banking in the United States", John Jay Knox, Bradford-Rhodes and Company (1900) -- Pages 412-413


BANK
DEPOSIT GUARANTY SYSTEM
IN THE
UNITED STATES
WASHINGTON
OREGON
CALIFORNIA
NEVADA
IDAHO
MONTANA
WYOMING
UTAH
ARIZONA
COLORADO
NEW MEXICO
NORTH DAKOTA
SOUTH DAKOTA
NEBRASKA
KANSAS
OKLAHOMA
TEXAS
MINNESOTA
IOWA
MISSOURI
ARKANSAS
LOUISIANA
WISCONSIN
ILLINOIS
MICH.
INDIANA
OHIO
KENTUCKY
TENNESSEE
MISSISSIPPI
ALABAMA
GEORGIA
FLORIDA
SOUTH CAROLINA
NORTH CAROLINA
VIRGINIA
W. VA.
PENN.
MD.
N.J.
NEW YORK
VT.
MAINE
N.H.
MASS.
CONN.
R.I.
STATES HAVING GUARANTY SYSTEM
" NOT " " "
SAVINGS BANKS ONLY.

Chapter Two

THE GUARANTY OF BANK DEPOSITS BY STATES

Introduction

The history of bank deposit guaranty in the United States subsequent to the New York Safety Fund System is an interesting chapter in American banking history. During the period between 1907 and 1930 eight of the so-called prairie states enacted laws to protect the depositors in banks within the boundaries of the particular state against loss from bank failures.

The deposit guaranty idea originated as a political party issue, and was made law in most of the states because of party pledges to the voters of the respective states. Moreover, the issue was advocated and sorely contested in states neighboring or bordering upon those which had advocated or enacted deposit guaranty laws. However, only eight state legislatures were successful in making possible the operation of a deposit guaranty plan for state banks.

The following pages trace briefly the history of the origin of deposit guaranty laws, the characteristics of the laws, their legality, the character of the deposit guaranteed, the assessments, the administration of the guaranty funds, and the payment of the depositors in closed or failed banks.

The Populist Movement

The guaranty of bank deposits by states had its origin in the Populist Party movement of the late eighties and early nineties[69]. During the Populist days, guaranty laws were part of the

[69] "The Guaranty of State Bank Deposits", John G. Blocker, Bureau of Business Research, Kansas Studies in Business, No. 11, July 1929 -- Pages 1-2

campaign platform of this party. There had been a great many bank failures in the State of Kansas and adjoining states during the years following the crop failures which began in 1887, and still more in the years following the depression of 1893. During the period from 1892-98, seventy-five state banks suspended operations, and during the period from 1890 to 1900, thirty-two national banks were closed. The remedy for this malady in the banking situation was seen in bank deposit guaranty legislation by the Populists.

In 1898 the Governor of Kansas called a special session of the legislature for the express purpose of considering the enactment of a deposit guaranty law. A law was proposed and passed the Senate, but failed to pass the House by four votes.

Parallel to the action being taken in Kansas, the States of Oklahoma and Nebraska undertook the agitation for guaranty of deposits in state banks. This movement in all three states lost headway, however, when better crops and rising prices in 1897 changed the economic situation in these states and silenced the Populist demands. In 1908 the movement was revived, and the demand for deposit guaranty legislation crystallized. Oklahoma passed a law on December 17, 1908, which had been introduced into the legislature only twelve days previous to this time. Kansas followed two years later, having failed in 1908 by a small margin to get the required support for a deposit guaranty bill, but in March 1909 Kansas succeeded in enacting a deposit guaranty law.

Characteristics of the State Guaranty Funds Laws

Each of the state guaranty plans provided for the creation of a guaranty fund to which the solvent banks of the state had to contribute regular and special assessments. This fund was drawn upon to cover the difference between the claims of the depositors in failed banks and the amount realized from the liquidation of the insolvent banks' assets. In no case did the state guarantee to pay the claims of depositors, assume the liabilities of the guaranty fund, or to attempt to meet any debts of the fund through general taxation.[70] The state acted solely in an administrative capacity.

Legality of the Guaranty Fund Plans

In all of the states the national banks located within the particular states were allowed to participate in the guaranty schemes. Many of these national institutions took advantage of the opportunity in order not to be placed at a disadvantage in attracting and holding deposits. The participation by the national banks was short-lived, however, because Attorney-General Bonaparte ruled that the national banks had no right to submit to state legislation. It was his opinion that the Oklahoma law required a bank to guarantee the obligation of a third party, and that such a privilege was denied the national banks by federal banking laws.[71] The constitutionality of the guaranty fund laws was contested in three states: Oklahoma, Kansas, and Nebraska. The three cases were reviewed together, and in a decision handed down on January 2, 1911, the guaranty laws were

[70] Ibid., Page 12
[71] Ibid., Page 13

declared to be constitutional.[72]

Character of Deposits Guaranteed

The state guaranty funds excluded the protection of all deposits except those of individuals[73], and, in addition, all deposits which were secured in some other manner were excluded from protection. It was provided further that the guaranty funds should not protect discounted bills endorsed by the banks, bills payable, and money loaned to officers. In the majority of the states the law declared specifically that deposits upon which the rate of interest paid was higher than that approved by the Bank Commissioner should be classified as money borrowed and not guaranteed.

Assessments

In all the states except South Dakota both regular and special assessments were required.[74] Regular assessments were collected semi-annually in Nebraska, and annually in the seven other states. These assessments ranged from one-twentieth of one per cent of the average daily deposits in Kansas to one per cent of average daily deposits in Washington. The special assessments for emergency situations ranged from one-fifth of one per cent in Oklahoma to two per cent of average daily deposits in Texas. The maximum assessments ranged from one-fifth of one per cent of average daily deposits in Oklahoma to two per cent in Texas. In addition to regular and special assessments, the State of Washington had a contingent fund to pay the expenses incurred by the Guaranty Fund Board of the State. The contingency

[72] Ibid., Page 13
[73] Ibid., Pages 14-15
[74] Ibid., Pages 16-17

fund assessment was one-tenth of one per cent of average daily deposits eligible for guaranty in the preceding year, with a maximum of three per cent of eligible deposits.

Additional Requirements

In addition to the foregoing special and regular assessments for the creation of a guaranty fund, the states of Oklahoma, Texas, Washington, and Mississippi required from each bank a deposit in cash, securities, or other valuables as evidence of good faith and a guarantee that the bank would pay assessments when due. In Oklahoma, Texas, and Washington this was one per cent of average daily deposits, and one-half of one per cent of average daily deposits in Kansas and Mississippi. For banks which were organized subsequent to the establishment of the guaranty fund the requirements were different. In Oklahoma and North Dakota new banks had to pay into the fund an amount equal to three per cent of their capital stock; in Texas, an amount equal to three per cent of the new bank's capital stock and surplus; while in Nebraska and South Dakota, the assessment for a new bank was four per cent of the capital stock.[75]

Investment of Guaranty Fund

The investment and custody of the different guaranty funds was not alike in all the states.[76] In Nebraska, North Dakota, and South Dakota the member banks were given the custody of the funds. The State Banking Board was required to notify the banks of the amount of the assessments due, and then the bank was required to set aside this amount of money which was to be held

[75] Ibid., Pages 15-16
[76] Ibid., Page 18

payable on demand.

The States of Kansas and Mississippi required the State Treasurer to collect the assessments and deposit the same in the state depository banks subject to the order of the Bank Commissioner. In Oklahoma the scheme was much the same, except that the fund was invested in securities and twenty-five per cent had to be held by the Banking Board of the State as a ready fund.

In Texas and Washington a portion of the deposits were deposited with the State Treasurer, and the remainder was credited on the books of the bank liable for the assessment to the Banking Board or Commissioner.

Duties of Guaranty-Fund Administrators

The states having deposit guaranty laws placed them in charge of a board or commission whose function it was to do the following: Levy and collect the assessments, act as custodian of the fund, receive and approve claims of the depositors in failed banks, liquidate the assets of the closed banks protected by the fund, issue certificates or warrants of indebtedness, and publish periodically reports concerning the status of the fund.[77]

Methods of Paying the Depositors in Failed Guaranteed Banks

In the states of Oklahoma, North Dakota, and South Dakota it was the duty of the Bank Commission of the State to take charge of an insolvent bank and distribute the cash on hand in the bank to the depositors in the bank immediately.[78] When this cash proved to be insufficient to meet the deposit liabilities of the bank which had failed, the balance was to be paid from the

[77] Ibid., Page 17
[78] Ibid., Pages 19-21

guaranty fund. The Commissioner then liquidated the assets of the closed bank and reimbursed the guaranty fund to whatever extent possible from the amount realized from the liquidation of the assets of the bank.

In addition, when the guaranty fund and the maximum assessment together proved to be insufficient to pay the depositors, it was the duty of the banking board or other proper authority to issue interest-bearing warrants or certificates of indebtedness to the depositors. Many times the warrants or certificates were sold to the public in order to obtain the cash needed to pay the depositors. The subsequent assessments made for the benefit of the guaranty fund were used to retire the certificates issued in the order in which they had been issued. This procedure was really using the guaranty fund as security to borrow money to operate the system.

In the states of Kansas, Mississippi, and Washington it was the duty of the Bank Commissioner to take charge of closed banks and issue immediately interest-bearing certificates to the depositors having claims upon the closed banks. These certificates were redeemed or paid as fast as the assets of the closed banks could be liquidated. When the liquidation proceedings provided insufficient money to cancel the certificates, the State Treasurer paid the balance from the guaranty fund, and if the guaranty fund plus the special assessments allowed failed to provide the amount necessary to pay all the depositors, the depositors remaining unpaid were to be paid on a pro-rata basis and balance

paid when the next assessments became available.

In the State of Nebraska the law provided that the Guaranty Fund Commission's expenses were to be levied against the banks whose deposits were protected. The expenses could not exceed $15,000 in any one year, nor more than $10. per day for a member of the board for any working day.

In regard to the payment of depositors, the law provided that when the Department of Trade and Commerce became convinced that the capital of the bank was impaired or that the bank was insolvent for any reason it should take over the bank in question. The Department of Trade and Commerce had to turn over the bank to the Guaranty Fund Commission whose function it was to examine the bank and then close or operate it as it deemed wise for the interest of the depositors.

If the stockholders of the bank would agree to assign their stock to the Commission temporarily, the bank could be operated as a going concern, and if the bank's operation proved successful it had to be turned back to the original owners.

In order to prevent closing banks and to conserve the guaranty fund, there was created a "Bankers' Conservation Fund"[79] which was established by the assessment of any guaranty bank to an amount equal to one-fourth of one per cent of its average daily deposits in any one year. This Fund could not exceed one-third of the average daily deposits of a bank at any one time. The Fund so created was to provide the capital needed to operate a bank taken over by the Guaranty Fund Commission. The bank be-

[79] Ibid., Pages 20-21

ing operated by the Commission could not be returned to the original owners until the money borrowed from the Bankers' Conservation Fund was repaid in full with interest at five per cent.

If the Guaranty Fund Commission decided to liquidate the bank, a receiver was to be appointed and the process of liquidation begun. The receiver was empowered to issue receiver's certificates in an aggregate amount not exceeding the amount required to supply the deficiency for the payment of depositors in any failed bank.[80]

The certificates so-issued were to bear interest at a rate determined by the courts, and could be issued to pay depositors in the failed bank or to reimburse the Guaranty Fund.

In the State of Texas it was provided that certificates were to be issued when a bank failed. The depositor received all the cash available in the failed bank at once, and the Guaranty Fund was drawn upon for the rest until the Fund was depleted. The receipts from the liquidation of the bank were to be used to reimburse the Guaranty Fund.[81]

COMPULSORY AND VOLUNTARY GUARANTY PLANS

The state deposit guaranty systems put into operation were of two distinct types: (1) the compulsory guaranty system whereby all state banks had to become "guaranty" banks, and (2) the voluntary guaranty system, under which a state bank was at liberty to choose between becoming a "guaranty bank" or remaining outside the state guaranty system.

[80] Ibid., Pages 21-22
[81] Ibid., Page 22

There were five states which adopted the "compulsory" system. The following table shows the name of the State and the year when its guaranty system became law[82]:

State	Year Law Passed
Oklahoma	1908
Nebraska	1909
Mississippi	1914
South Dakota	1915
North Dakota	1917

Three states elected to set up "voluntary" guaranty plans. These states and the year of the establishment of the plans were:[83]

Kansas	1909
Texas	1910
Washington	1917

The tables show that there were really two periods when the state deposit guaranty plans were most popular. The first period was that directly following the enactment of the Oklahoma law which had its origin in the panic of 1907. The Oklahoma plan seemed feasible and the States of Nebraska, Kansas, and Texas adopted the deposit guaranty idea within a short time and before it had had an opportunity to prove its worth.

The second period of interest in the deposit guaranty idea came shortly after the beginnings of the prosperity wave which resulted from the World War. The prices of commodities had begun to rise and because the banks were sharing in this improvement in business conditions, the deposit guaranty systems which had fallen into disrepute a year or two before, seemed to be working out of their difficulties and getting on a sound basis. The States of Mississippi, South Dakota, North Dakota, and

82 "Barron's", June 12, 1933, Page 5
83 Ibid.

Washington enacted laws at this time.

COMPULSORY GUARANTY SYSTEMS

Of the compulsory guaranty systems, the Oklahoma law was the most outstanding. It was the first one to be enacted and had the longest life.

The Oklahoma System[84]

The Oklahoma deposit guaranty system had two outstanding characteristics: (1) the law was compulsory -- all state banks had to qualify and come under its supervision -- and (2) the depositors in failed banks were to be paid at once.

The law provided that the funds for meeting the requirements of the law should be obtained by an assessment of the capital stock of banks and trust companies. The original law provided for an assessment equal to one per cent of the average daily deposits, and when the deposits of a bank grew, the bank had to pay into the guaranty fund a sum equal to one per cent of the increase in deposits. This was changed by an amendment to a fund equal to five per cent of the average daily deposits; one per cent was to be paid in during the first year of membership, and the remainder to be paid in annual installments equal to one-fourth of one per cent of the average daily deposits until a fund of five per cent was accumulated. This was changed finally to two per cent in 1913.

Whenever the guaranty fund became depleted, the funds necessary to pay the depositors in closed banks were to be derived by a special assessment levied against every bank. At first

[84] "The Guaranty of Bank Deposits", Thomas B. Robb, Houghton-Mifflin (1920) -- Pages 26-31

special or extra assessments amounting to two per cent of the average daily deposits were allowed, but during the year 1914, 1915, and 1916 the banking board was restricted to an assessment of not more than one-fifth of one per cent of the average daily deposits, and after 1916 the special assessments were prohibited altogether. It was found that these were too great a tax upon the banks and could not be made when the banks found it convenient to pay. Instead of the special assessment it was provided that when the fund proved to be inadequate to meet the demands for payment of depositors in closed banks, such funds should be derived by the sale of notes bearing six per cent interest. These were secured by the capital stock, surplus, and undivided profits of each and every bank. The notes were to provide cash essential to the demands of the closed bank depositors, or could be used to pay a depositor. Of course such notes or certificates were readily sold and accepted because the solvent banks themselves were willing to accept them as deposits and were eager to obtain them for investment.

The Oklahoma law made a rather unusual provision for the payment of the assessments was to be made by non-interest bearing cashiers' checks which were to be held by the board until needed. To secure its liability to the fund each bank was required to deposit a bond or warrant equal to one per cent of its deposits, but not less than $500. It was provided that seventy-five per cent of the fund was to be held in state warrants, and twenty-five per cent to be held by the banking board for ready cash.

The custody of the fund and the administration of the law was originally placed in a board consisting of the Governor, the Lieutenant Governor, the President of the Board of Agriculture, the State Treasurer, and the Auditor. It can be seen at a glance that this board was purely political and likely to prove incompetent when it came to dealing with the intricacies of banking and particularly bank liquidation.

It is not at all surprising, then, that the banks clamored for a more competent board when they began to feel the pinch of assessments because of bank failures. It was proposed that the board be placed in the hands of bankers and their representatives who would serve without pay. This proposal was accepted in 1913, and a new board was created as follows: Each bank was to have one representative in an association of state banks, and this association was to select an executive council of not less than nine nor more than fifteen members. The council was to recommend to the Governor the names of nine men competent to serve on the board, and from these nine names submitted, the Governor was to select the names of three men to make up the Board with the Commissioner of Banks and the Assistant Bank Commissioner.

The duties of the new board were as follows: (1) to render an account of the collection of the depositors' guaranty fund; (2) show all collections from the assessments and the assets of closed banks; (3) make disbursements from the fund to pay certificates of indebtedness and other obligations; (4) send each

bank a quarterly financial statement showing the exact condition of the depositors' guaranty fund.

It was provided by law that when a bank failed, the Bank Commissioner should take charge. After due examination of the bank, he was instructed to take possession and liquidate its assets to pay depositors in full. Whenever the funds from liquidation were found to be inadequate to pay the depositors in full, it became the duty of the Banking Board to draw upon the fund to pay the depositors in full. Up until 1916 the Board was empowered to make extra assessments to provide funds for the payment of depositors whenever it was found that the guaranty fund was inadequate. (When the assets were found to be so inadequate that a loss was to result from liquidation of the bank, the guaranty fund had to stand the loss.) Furthermore, it was provided that whenever the guaranty fund and the special assessments were insufficient to pay the depositors in closed banks in full, the Banking Board was to issue certificates (notes) bearing six per cent interest. These could be issued to anyone.

When a bank complied with the Oklahoma law it was entitled to receive from the Commissioner of Banks a certificate stating that its deposits were guaranteed by the State Guaranty Fund. The bank was allowed to advertise this fact and display the certificate.

The Oklahoma law provided that deposits otherwise secured were not to be protected by the State system. Furthermore, it provided that the State Guaranty Fund did not apply to deposits

upon which more than four per cent interest was paid.

Trust companies were admitted to the Guaranty plan in 1911 and had to pay into the fund a sum equal to three per cent of their capital stock.

The Oklahoma System in Operation

"The Quarterly Journal of Economics" for November 1914 published an article by Thornton Cooke of Kansas City in which the failure of the Oklahoma deposit guaranty system was predicted.[85] Mr. Cooke was intimately acquainted with the operation of the system. It was his opinion that the Oklahoma system was doomed to failure at its inception because of the payment of depositors as soon as the bank closed its doors.[86] Furthermore, the law came at an inopportune time in the history of the State. This fact is well substantiated in a letter from the Bank Commissioner in Oklahoma to Mr. George H. Shibley, Director of the American Bureau of Political Research, Washington, D.C.:[87]

June 29, 1914

Mr. George H. Shibley
Director American Bureau Political Research
Bliss Building
Washington, D.C.

Dear Sir:

In reply to your letter of the 26th instant relative to the operation of the depositors guaranty fund in this state, I desire to advise you that at the time our guaranty law became effective banking conditions in this state were very chaotic, as the state banks in the Indian Territory section had not been subject to examination.

Another thing, this was a new country and property fluctuated considerably, and we had almost a crop failure

85 "Quarterly Journal of Economics", November 1913, Pages 69-114
86 Ibid.
87 Senate Document, Volume 28, 63rd Congress, 2nd Session, 1914, Page 9

> in this State for three successive years. On account of adverse conditions, the first few years of operation of our depositors' guaranty law proved very expensive to our banks, which no doubt caused a number of them to nationalize. However, at this time we feel that our guaranty fund is now established on a solid and substantial basis, and we feel that the future success of our guaranty law is assured. Our last legislature passed several amendments to our guaranty law which have proven very beneficial.
>
> I am herewith enclosing you a list of the aggregate individual deposits of our State banks on the data of each call since statehood. If there is any other information that you desire relative to our laws, please advise me.
>
> (Signed) R. C. Stuart

As a result of these conditions in Oklahoma, the State Banking Department kept open many State banks when they knew they were insolvent[88], merely to make a showing for the guaranty program. Within a period of five years there were thirty bank failures, almost all of which came during the first three years of the existence of the guaranty system. This was the period of collapse following the boom of the early days of statehood, and many banks were caught in the crash. For example, the Citizen's Bank of Mountain Park failed in April 1911 and it was found that twenty-five per cent of the notes of this bank represented fraudulent transactions of the bank's officers.[89]

It would have been possible under the Oklahoma system to pay some depositors by issuing six per cent interest-bearing warrants to the depositors when a bank was found to be insolvent. The law provided that such warrants should be issued when the guaranty fund was found to be inadequate to pay losses resulting

[88] Senate Document, Volume 28, 63rd Congress, 2nd Session, 1914, Page 9

[89] "Quarterly Journal of Economics", November 1913, Pages 75-76

from failures. Instead of following this course banks were kept open until, as a last resort, they had to be closed, and then the banking board of the State pledged the guaranty fund to borrow money to pay depositors cash, issuing warrants against the fund. There was no authority in the law allowing this, but it was done in order to pay depositors in closed banks in cash as soon as the bank failed.

When the Columbia Bank and Trust Company of Oklahoma City failed, the Banking Department paid immediately all the depositors without troubling to ascertain the losses of the bank. This action of the banking board seems almost incredible when it is realized that this bank was the largest failure the fund ever had to withstand both from the point of time and amount of assets involved. When the affairs of the bank were finally looked into, it was found that there was a discrepancy of $70,000 between the books and notes of the bank.[90]

There is another example that demonstrates more clearly the extremes to which the banking department went to make a good showing for the guaranty fund: The Planters and Mechanics Bank of Oklahoma City became insolvent and was kept going long after the condition was known to the department, but instead of closing the bank, the Banking Board bought some of its poorest securities to help out the condition of the bank.

In the year 1914 the annual assessments of deposits in Oklahoma banks amounted to about one per cent of the total deposits. In June of 1914 the condition of the guaranty fund was

[90] "Quarterly Journal of Economics", November 1913, Page 79

far from satisfactory. The fund owed $419,926.56 in unpaid warrants, and had only $35,000 on hand to meet these.[91]

During a period of four years ending in 1914 the assessments upon certain banks in proportion to their capital were as follows:

Capital Paid	Assessments
$50,000	$13,000
50,000	15,000
10,000	1,300
15,000	3,000
5,000	2,255
30,000	20,000

Many of the banks attempted to escape the assessment burdens by relinquishing their state charters and becoming national banks. This proved futile, however, because the court held that a national bank is liable for all assessments made prior to its nationalization.[92] In the year 1911 sixty-five banks nationalized. In January 1910 there were two hundred and nineteen national banks, which number had increased to three hundred and twenty-six in 1913. This was a substantial increase, but it did not include all the state banks under the system capable of becoming national banks.

In view of the heavy losses which the Oklahoma system had sustained, and in view of these conditions which have been described, Mr. Cooke concluded in 1914 that the Oklahoma system would fail. He stated six reasons why he believed this to be inevitable:[93] (1) The Banking Department of the State had been in politics for a long time and this meant the continuation of unsound practices such as those described. If it were considered

91 "Quarterly Journal of Economics", November 1913, Page 86
92 Ibid., Page 87
93 Ibid., Page 93

politically expedient to keep a bank open, this would be done. (2) Unsound banks had been admitted and guaranteed at the outset of the system. These banks were bound to cost the system a large sum of money when it should have been building up reserves. (3) The record of bankers running banks had not been properly traced when banks were admitted to the system. A guaranty system does not make honest bankers dishonest, but it encourages the dishonest to get into the banking business. (4) The banking board had procrastinated in the face of losses, and had shown timidity in the face of losses. There was no reason, in the opinion of Mr. Cooke, why the Oklahoma Banking Board could not have closed the insolvent banks and issued interest-bearing warrants to the depositors rather than paid them in cash when the banks were closed. (5) The Oklahoma guaranty system came into existence under adverse economic conditions. The system was born in the panic of 1907, and conditions were not greatly improved for several years thereafter in the State of Oklahoma. (6) The guaranty of deposits relieved depositors of all necessity for care in selecting banks. This lack of interest in good banking encouraged the undesirable institutions. There was no premium on good management in the eyes of the public. In predicting failure of the Oklahoma system, Mr. Cooke stated that the cause would not be the guaranty system alone (paying depositors immediately), but the system plus ineffective examinations, insufficient scrutiny of the previous records of bankers, unfavorable economic conditions following the period of settlement, and rapid growth.

Such conditions encouraged dishonest banking.

Mr. Cooke stated that he did not believe the first four of his arguments were good arguments for the failure of all deposit guaranty systems. It is possible to eliminate politics from bank supervision, to find out the records of men wishing to organize a bank, to have efficient examinations of banks, and to close weak banks without temporizing. In substantiation Mr. Cooke pointed out that in states where conditions are more settled than in Oklahoma, the losses from bank failures are few.

Failure of the Oklahoma System[94]

In 1923 the Oklahoma deposit guaranty system law was repealed. In the fifteen years of its existence, the guaranty fund had not been able to get sufficient foothold to withstand the steady tide of failures that began soon after the law was enacted and put into operation and which continued after its removal from the statute books.

Oklahoma had shared in the boom which resulted from the sale of agricultural products to the European nations at war, but the effects of the boom were too short-lived to give any headway to the Oklahoma program.

Statistics of bank failures in the State of Oklahoma during the period from 1913 to 1923 are as follows:[95]

94 "Collapse of Bank Deposit Guaranty in Oklahoma and Its Position in Other States", Thornton Cooke, Quarterly Journal of Economics, Volume 38, No. 1 -- Pages 108-139

95 Ibid., Page 111

Year	State Banks	Year	National Banks	Capital	Deposits
1913-14	21	1919	1	$ 25,000	$ 382,869
1915-16	6	1921	3	325,000	1,551,155
1917	4	(Reopened	2	225,000	1,313,510
1918	2	1922	3	500,000	2,274,582
1919	5	(Reopened	1	100,000	314,129
1920	8	(Second Failure	1	200,000	929,662
1921	27	1923	3	200,000	2,008,712
1922	32				
1923	16				

In 1914 the guaranty fund owed $419,926.56 in unpaid warrants, and had only $35,000 on hand to meet these (see page 93). The growth of state bank deposits and the decrease in bank failures enabled the guaranty fund to catch up with its obligations, and on March 1, 1920, the fund had $75,000 in the treasury. During this period from 1916 to 1920 thirty-one national banks took out charters; these banks had a total capital amounting to four million dollars.

Unfortunately, however, the war had not saved deposit guaranty in Oklahoma. Economic conditions after the war changed abruptly from what they had been. The change in income to the Oklahoma farm population may be readily seen from these figures:[96]

	1919	1920
Wheat Crop	$107,000,000	$73,000,000
Corn "	94,000,000	42,000,000
Cotton "	209,000,000	96,000,000

(In 1920 100,000 acres of the cotton crop remained unpicked.)

It was impossible to have such a drastic curtailment of income in a state where a large part of the income was derived from farming operations without its being felt keenly by the banks of the state. This unexpected change in market conditions made it

[96] Ibid., Page 111

impossible for the farmers who had borrowed heavily from banks to finance their crops to pay their notes at the banks.

In the year 1921 it was necessary to issue warrants for $2,196,000 to cover the deposits in thirteen banks. On November 1st of the same year the Bank of Commerce at Okmulgee failed, involving deposits of $1,732,540. This failure was too much for the guaranty system to shoulder and it broke down completely.

The situation in which the guaranty fund found itself is well portrayed by these figures:[97]

Warrants Issued	$2,196,000
One-half Deposits of Other Failed Banks (Loss Estimate)	1,158,000
Liability of Fund	$3,304,000
6% Interest On	$ 201,340

The total deposits subject to assessment for the benefit of the guaranty fund amounted to only $156,000,000 at this time. Under the provisions of the guaranty law it was possible to make a maximum assessment of one-fifth of one per cent of these deposits. This assessment would produce only $312,000 annually, thus giving $111,000 to apply on the principal annually. At this rate it would require twenty years to repay the depositors in failed banks, provided no more failures took place.

In 1922 there were thirty-two more bank failures involving deposits of $7,230,000, not counting four banks which failed and reopened.[98]

The condition of the guaranty fund in 1921 caused forty-five

97 Ibid., Page 112
98 Ibid., Page 114

state banks to convert to national charters, which number was increased by fifty-nine additional banks in 1922, and still another seventeen in 1923. By January 1923 the number of guaranty banks had fallen to 453, having deposits of $78,000,000.

In January 1923 the Democratic party in the State of Oklahoma campaigned on a platform favoring the continuation of the guaranty law. The depositors were promised the return, at the earliest possible date, of every dollar claimed "at no expense to the tax payers".

A bill was proposed in the legislature of that year to issue bonds to pay off the depositors, the principal and interest of the bonds to be payable out of the assets of closed banks and from certain taxes and fees. This bill failed passage on the grounds that the State held no obligation to pay depositors in closed banks.

On March 31, 1923, the guaranty fund law was repealed by the State Legislature and pronounced a failure as a plan for protecting depositors.

In the fifteen years of deposit guaranty to January 1, 1923, the system had cost Oklahoma banks $3,647,486.32. The fund itself contained only $85,000, and outstanding against it were warrants of $1,336,999.27. The deposits in banks closed before the repeal of the law and still in liquidation amounted to $9,373,117.23. The assets were nominally stated at $13,027,559.64 and capital at $1,267,000.[99]

[99] Ibid., Page 120

THE NEBRASKA SYSTEM[100]

The second of the compulsory deposit guaranty systems was established under an act of the Nebraska Legislature in March 1909. The law became effective on July 1st of the same year.

The "original act" provided that any state bank or trust company or corporations doing a banking business (not excluding banks) were eligible to join the system, provided they had been in business for a period of three months prior to making application to become a guaranty bank. It was provided also that a bank which joined the guaranty system could not withdraw its membership.

The Fund

Under the Nebraska system there was no limit to the amount of the fund that could be created to guarantee deposits. It was provided in the first law that each bank should pay four assessments amounting to one-quarter of one per cent of its average daily deposits to the state banking board between July 1, 1909, and January 1, 1911. This meant that each bank had to pay to the state banking board assessments amounting to one per cent of deposits within a period of two years. Beginning on January 1, 1911, each bank was to be assessed an amount not in excess of one-tenth of its average deposits, which assessments were to be paid in two installments of one-twentieth of one per cent average deposits on a semi-annual basis. It was provided also that special assessments not in excess of one per cent of average deposits per annum might be levied when the guaranty fund became

100 "State Banks, Trust Companies, and Independent Treasury System" (Publication of National Monetary Commission), Volume VII -- Pages 315-318

less than one per cent of average daily deposits.[101] (For other provisions see chart on page 213.)

Under the Oklahoma system it was provided that the assessments should be paid to the guaranty fund board, while in Nebraska the act stipulated that assessments payable to the guaranty fund should be retained by each bank in the system. Each bank had to credit the total of its payments to the fund to the state banking board, payable on demand.

This plan of allowing the banks whose deposits were being guaranteed to keep the guaranty fund in their own hands was a weak feature of the Nebraska system. Unfortunately, the idea spread and was adopted by other states. The danger is summed up well in a statement by Mr. Thornton Cooke in his report on the state guaranty systems for the National Monetary Commission in 1911: "This is an arrangement which might easily lead to trouble. Insurance premiums, for that is what these assessments are, should be paid over to the insurer, not held by the insured, subject to all sorts of claims and processes if the insured happens to think his insurance is proving too expensive."[102]

Payment of Depositors in Failed Banks

Under the Nebraska guaranty law all the deposits of banks operating under the system were insured. When any one of these banks failed, it was provided that the depositors should be paid in full as soon as the deficiency in the cash of the failed bank was ascertained by its receiver. The funds necessary to meet the deficiency had to be obtained by drawing checks against the

101 "The Guaranty of Bank Deposits", T. B. Robb, Houghton-Mifflin (1920), Page 133

102 "State Banks, Trust Companies, and Independent Treasury System", Volume VII -- Page 316

"assessment accounts" standing to the credit of the guaranty fund in all the state banks.

When the fund became depleted it was necessary to levy the special assessments not in excess of one per cent of the average deposits of any one bank for any one year. The original law made no provision for the payment of depositors when the special assessments proved to be inadequate to meet the demands of depositors in failed banks. (For other provisions see chart on Page 213.)

Bankers' Conservation Fund[103]

The Nebraska plan of deposit guaranty provided for the establishment of a fund known as "The Bankers' Conservation Fund". The purpose of this fund was to conserve the Nebraska guaranty fund. It belonged to the banks contributing to it, and each contributing bank had to hold subject to demand its payment to the fund. The annual assessments of the Conservation Fund could not exceed one-fourth of one per cent of the average daily deposits of each contributing bank, and the Fund could not exceed one-third of the average daily deposits of contributing banks.

The Fund was to be used to supply capital for banks operated by the Guaranty Fund Commission. Moreover, no bank could be closed or returned to owners until the loan from this Fund had been repaid with interest at five per cent. It was hoped this Fund would make it necessary to close less banks and, therefore, bring less burden upon the State guaranty program.

103 "The Guaranty of State Bank Deposits", John G. Blocker, July 1929, Bureau of Business Research, Kansas Studies in Business -- Pages 20-22

Additional Banking Legislation[104]

At the time the deposit guaranty system was created, the Nebraska Legislature took steps to strengthen the regulation and supervision of banks in the state. The capital requirements for organizing a new bank were increased, and the qualifications to be met in becoming a bank director were made less liberal. In some respects the requirements exceeded those for national banks. Finally, the state passed a law forbidding individuals and firms the privilege of carrying on a banking business.

How Deposit Guaranty Worked in Nebraska

The Nebraska deposit guaranty system was one of the last of the state guaranty plans to be repealed. In its operation it had differed from the others in the operation of a so-called Bankers' Conservation Fund, and was generally considered to be one of the better deposit guaranty plans put into operation. Its failure was significant. The Bankers Magazine for April 1930 carried this statement: "Since the Nebraska law is rather carefully drawn, it seems reasonable to conclude that its failure was due to the fact that the principle itself was unsound."[105]

The Nebraska guaranty system went through two periods. For nine years it was a great success. From June 1911 when the law became effective until June 1920, the system had created a fund of $2,367,000 and the drafts against this fund had been only $239,330.[106] This amounted to a utilization of about ten per cent of the fund to pay in full the depositors of five insolvent banks. The second period of the plan's operation was a stormy

---

104 "State Banks, Trust Companies, and Independent Treasury System", Volume VII -- Page 317

105 "Bankers Magazine", April 1930, Volume CXX, No. 4 -- Page 47

106 "How Nebraska Sowed Deposit Insurance and Reaped Bankruptcy", Executives' Magazine, Oct. 1933, Vol.XVII, No. 5 -- Page 13

one and lasted for ten years.

During the first period of the operation of the guaranty system, the banks of the State of Nebraska had increased in number fifty-five per cent, while deposits had increased four hundred and fifty-seven per cent. During this same period, the state banks in the nation had increased only thirty-three per cent, and deposits in these banks, one hundred and twenty-six per cent. The guaranty plan in Nebraska was given all the credit for the phenomenal growth, and money poured into Nebraska banks from all the neighboring states.

During this same period, national banks in the State decreased from 231 to 175, a decrease of twenty-four per cent. Deposits in national banks increased less than seventy-four per cent, one-sixth as fast as the guaranteed deposits of state banks.[107]

There were in 1920 1,090 persons to a bank as compared to 1,360 when deposit insurance began. A hamlet of one hundred people might have a bank with a capital of $10,000. Two-thirds of the banks had less than $20,000 capital.

At the end of the nine-year period prices began to fall. Nebraska is a State having agriculture as its industry. In 1929 it was the second hog producing state, third corn producing state, and third winter wheat state for five consecutive years ending in 1929. The State had no mineral resources, and the manufactures were in the food industries group. It was to be expected that declining prices for agricultural commodities would have a serious

[107] Ibid.

effect upon banking conditions.

In 1920 there were two hundred and ninety-one million dollars worth of deposits protected by a guaranty fund of less than two and one-half million. In 1921 the assessment of state banks amounted to $2,300,000. In 1922 there was an additional assessment of $1,970,000. In 1923 there was $2,050,000 more. In 1922 the fund was bankrupt and hopelessly so in 1923.[108]

The number of state bank failures by years beginning in the year ending June 30, 1921, were as follows:[109]

1921	16	1926	23
1922	23	1927	19
1924	19	1928	44
1925	11	1929	106

In 1922 the state bankers formed an Agricultural Loan Association which sold $2,000,000 worth of stock to member banks, and used the fund so created to pay depositors in failed banks, the assets of which banks were taken over by the Association. This Association attempted to operate some of the crippled banks which did not seem to be beyond repair.

In the year 1926 it seemed that the crisis was past. There were thirty-eight banks being operated by the Loan Association and the losses to be met for failed banks were estimated at $6,000,000[109]. It seemed possible to pay off this amount in three years time. However, in 1927 the crisis came when the bankers lost faith in the value of the guaranty fund certificates and refused to invest further in them. There was no means left to raise money except through special and regular assessments.

108 Ibid.
109 Ibid.

By 1929 there were one hundred and thirty-five banks in the hands of the Guaranty Fund Commission with unpaid deposits amounting to $25,000,000 of which sixty-one were in receivership by court order.

In February 1929 there was sent to each bank in the state a questionnaire which asked, "Do you favor repealing the guaranty law as a whole?" Five hundred and ten banks answered and of these, three hundred and seventeen votes were for repeal and one hundred and sixty-nine against.

The following table shows the total assessments paid to the guaranty fund by Nebraska banks expressed as a percentage of the total capital investments in these banks for the years 1911-29:[110]

1911	1.0%	1920	1.7%
1912	2.0	1921	6.7
1913	1.4	1922	5.9
1914	0.7	1923	6.2
1915	0.6	1924	3.1
1916	1.7	1925	5.3
1917	0.8	1926	5.5
1918	1.0	1927	5.7
1919	2.2	1928	3.2

These statistics are sufficient to show the impossibility of operating a bank profitably and still continue to meet the requirements of a compulsory guaranty system.

The will of the bankers was recognized by the legislature of the state and the law was repealed in March 1930. The fund was insolvent at repeal, and had been for eight years. It had unpaid liabilities amounting to nearly $20,000,000[111].

110 "The Guaranty of State Bank Deposits", John G. Blocker, Bureau of Business Research, Kansas Studies in Business, No. 11, July 1929 -- Page 37

111 "How Nebraska Sowed Deposit Insurance and Reaped Bankruptcy", Executives' Magazine, October 1933, Vol. XVII, No. 5, Page 13

Outcome of Other Compulsory Guaranty Systems

The following pages will outline briefly the results of compulsory deposit guaranty programs put into operation in the States of Mississippi, South Dakota, and North Dakota.

Because of the similarity of all of the state plans establishing compulsory deposit guaranty systems, the complete details of the laws enacted in these states will not be presented except in chart form as found on Page 213. This chart shows the fundamental points of each of the state plans and gives the reader an opportunity to make a comparison of the various state guaranty laws.

Deposit Guaranty in Mississippi

The Mississippi law creating deposit guaranty was passed on March 9, 1914, but did not become effective immediately. It was compulsory for all state banks on May 15, 1915. (See chart on Page 213.)

From 1915 to 1920 only seven banks failed, and the highest levy made upon member banks was one-fifth of one per cent in 1916. However, as was the case in the other systems, the depression of 1920 and the years directly following proved to be the undoing of the system. During the years 1921-1922 fourteen state banks failed, and the maximum assessment was levied each year which was five assessments of one-twentieth of one per cent of average daily deposits, in addition to the annual assessment of one-half of one per cent of average daily deposits less capital and surplus.[112]

---

112 "The Guaranty of State Bank Deposits", John G. Blocker, Bureau of Business Research, Kansas Studeis in Business, No. 11, July 1929, -- Page 41

By April 15, 1925, guaranty fund certificates to the amount of $3,162,748 had been issued. In June of that same year there was outstanding $1,940,766. During the period from 1915 to 1925 the assessments for the benefit of the guaranty fund system had been $1,395,979. The depositors had been paid $1,766,769, the difference being the amount of assets that were realized. The certificates outstanding in June of 1925 were a deficit of the fund, and it was estimated that it would take six to seven years to retire these provided maximum assessments were made each year.[113]

In 1925, the deposits in state banks in Mississippi aggregated to $134,900,000. They rose to $153,500,000 in 1927 and in 1928, and fell to $134,900,000 in 1929. By 1930 they had fallen still lower to $132,200,000.[114]

In March the deficit of the guaranty fund had risen to $5,000,000 because of increased bank failures and interest on certificates held by the depositors. These certificates were held by about 125,000 depositors in thirty state banks. This state of affairs led the state legislature to suspend the guaranty fund. This action put an end to the issuing of additional certificates but continued the assessments amounting to one-fourth of one per cent less capital and surplus for the liquidation of the certificates outstanding.[115]

This suspension law also levied a tax of three per cent against the capital and surplus of the state banks, the total revenue from which source could not exceed $300,000 in any one year. This sum was to protect deposits in banks failing

113 Ibid., Page 41
114 Ibid.
115 "The Guaranty of Bank Deposits", Economic Policy Commission, American Bankers Association -- Pages 24-25

subsequent to the elimination of deposit guaranty. The plan was not accumulative, there being no carry-over of such deficits and surpluses as might arise. The state banks were given other tax exemption privileges because of this special assessment.

The fundamental cause for the failure of the Mississippi system was the failure to create a sufficient reserve against the risks involved. During the period 1915-1925 the assessments of all banks amounted to about 1.2 per cent of all their capital. The deficit was $1,940,766. In order to have created a reserve adequate to take care of this sum it would have been necessary to levy annual assessments equivalent to about 2.65 per cent of the capital of the state banks. To take care of the 1930 deficit the creation of an adequate reserve would have caused an annual assessment amounting to three and one-half per cent of the capital of the banks.[116]

Deposit Guaranty in South Dakota

The South Dakota bank deposit guaranty law was passed in March 1915, and until June 24, 1921, there were only three bank failures. The law was hailed as a great success. In 1922 two banks failed, and by June 30, 1923, the guaranty fund had fallen to $94,000, all the depositors being paid in full in thirty days. During the next two years one hundred and thirty-nine banks failed and the fund became insolvent.[117]

The 1925 legislature repealed the law effective January 1st, 1926. However, prior to this time the state held an election and there was a referendum on the repeal of the guaranty law. The

116 Ibid., Pages 25-26
117 "The Guaranty of State Bank Deposits", John G. Blocker, Bureau of Business Research, Kansas Studies in Business, No. 11, July 1929 -- Pages 41-42

law was sustained.

By 1927 two hundred and ninety-seven banks had failed with deposits protected under the law. Of these failed banks, two hundred and forty-four remained closed. $54,000,000 of certificates had been issued to depositors and it was estimated that the assets of the closed banks would reduce these certificates by thirty to fifty per cent. The annual income of the guaranty fund derived from assets could not exceed $250,000. In addition there was an annual interest charge of two and one-half million dollars to be paid.[118]

In 1927 the South Dakota law was amended to state that depositors in banks failed after July first of that year should be protected only by a guaranty fund to be established by each state bank individually. However, other changes were made in the banking laws which provided little in the way of relief to the banks of South Dakota. The guaranty assessment of one-fourth of one per cent of average daily deposits was retained and had to be paid before any distribution of profits could be made to the stockholders of the state banks. It provided that these payments should be held by the State Treasurer for the credit of each bank, and could be invested under the direction of each paying bank for its account.[119] When the interest on the assessments so held and the additional assessments became equal to the paying bank's capital stock, no more payments by it were required and the additional earnings of the accumulated fund were to be paid to the bank. The capital sum remained the property of the

118 Ibid., Pages 41-42
"The Guaranty of Bank Deposits", Economic Policy Commission, American Bankers Association -- Pages 24-25

119 Ibid., Pages 28-29

bank and in case of failure the sum so accumulated was to be applied toward paying depositors of the failed bank.

In the year 1930 the Superintendent of Banks for the State of South Dakota stated that the deficit of the original guaranty fund as of June 30th of that year was $36,769,000. The new legislation changed the liability of stockholders from double to treble liability.

The Supreme Court of South Dakota declared in 1931 that the guaranty fund was a complete failure. The conclusion of the Court was in part:[120] "Whatever assets remain in the insolvent banks wherein their deposits were made properly applicable to that purpose will, of course, be received by the petitioners, but we can see no reasonable expectation of their receiving anything from the guaranty fund beyond what is therein ..... The guaranty fund in this, as in other states where it was attempted, has failed completely."

Deposit Guaranty in North Dakota

The North Dakota law was passed and became effective in 1917. (See chart on Page 213.) North Dakota was the last state to adopt a compulsory guaranty system.

Three years after the enactment of the law the depression of 1920-1921 brought catastrophe to the system. During the period from November 15, 1920, to December 31, 1928, three hundred and twenty-two state banks closed their doors. The assessment of three hundred and thirty-seven solvent state banks had yielded $1,957,679.31 which sum was sufficient to pay only ten per cent

[120] Ibid.

of the depositors of the three hundred and twenty-two closed banks.[121]

At the end of the year 1928, the outstanding certificates and claims eligible to guaranty amounted to $25,072,302 against which there were assets in the hands of the fund estimated to be worth about $13,000,000, leaving a deficit of $12,000,000 which was ultimately increased to $14,000,000. There was no provision for the payment of interest on these certificates and claims outstanding so the amount of the deficit remained fixed.

In 1928 the income of the guaranty fund was estimated to be $140,000 and this sum was bound to decrease because the deposits in state banks were rapidly shrinking. It was absolutely hopeless to attempt to wipe out this deficit with the annual receipts so small a fraction of the total obligation so a bond issue was proposed to pay off the depositors in closed banks.[122] The proposal was defeated by a large majority at the polls in 1928. The guaranty law was repealed in 1929.

VOLUNTARY STATE DEPOSIT GUARANTY PLANS

The States of Kansas, Texas,(1) and Washington established voluntary deposit guaranty plans. These plans were not different in fundamental principles from the other guaranty plans except for allowing the banks to become guaranty banks at their own discretion. However, this voluntary feature ceased to be such to all practical purposes when one or more banks elected to become guaranty banks. State banks which elected to remain non-guaranty banks were placed at a disadvantage in that the depositor was

(1) Texas plan voluntary in selection of one of two plans.

121 "The Guaranty of State Bank Deposits", John G. Blocker, Bureau of Business Research, Kansas Studies in Business, No. 11, July 1929 -- Page 45

122 "The Guaranty of Bank Deposits", Economic Policy Commission, American Bankers Association -- Pages 31-32

inclined to maintain his account with the bank which guaranteed that his money would be repaid in the event of failure of the bank. Few depositors were able to make a wise selection of a bank, and to avoid the assumption of risk, followed the easier course of electing to do business with a bank which protected the depositor's interest under a state supervised plan.

The State of Kansas was the first to establish the voluntary plan. It is desirable, therefore, to examine carefully the Kansas law guaranteeing deposits.

The Texas plan differed from the Kansas plan in that it was not only a voluntary system, but provided an optional system by which a bank might elect to guarantee deposits by adopting one of two plans.

The Washington plan lasted for only four years, enjoying the shortest life of all the systems. The law provided that all banks might withdraw by giving notice in writing and paying obligations to the fund, which provision helped end the system abruptly following a period of heavy assessments. The following pages will be devoted to a presentation of voluntary bank deposit guaranty as practiced in the three western states. (See Chart Page 114)

THE KANSAS SYSTEM[123]

In 1909 the State of Kansas enacted a law which was a radical departure from the Oklahoma law which had been enacted during the preceding year. In the enactment of this law an attempt was made to overcome some of the objections to the Oklahoma system. The Oklahoma plan was a compulsory system, all the banks of the

[123] "The Guaranty of Bank Deposits", T. B. Robb, Houghton-Mifflin (1920) -- Pages 146-149

State being obliged to adopt the guaranty plan; in addition, the Oklahoma plan provided that all bank depositors should be paid in full immediately when a bank failed. Under the Kansas system a bank was free to choose its own course. If it chose to remain outside the guaranty system, there was no objection on the part of the State authorities. Furthermore, it was impossible under a voluntary plan to contend that the honest banks in the system would have to pay the debts of the dishonest banks as was contended by those opposed to the Oklahoma plan.

Another point of departure from the Oklahoma plan was that the depositor in a failed Kansas bank was not paid in full immediately upon closing the bank. This was desirable in that a bank failure of considerable size could deplete the guaranty fund and cause unnecessary burdens upon the remaining banks in the system to replenish the fund.

Under the Kansas system it was essential for only one bank to elect to become a guaranty bank in order to put the system into operation. However, it must have been expected that more than one bank would become a guaranty fund bank because the admission of only one bank to the system would make possible a situation under which the guaranty fund established would be inadequate to take care of the losses that might result from the failure of this one bank. There could not be any assessments.

The Fund

There was no need for the creation of a large fund under the Kansas system since the depositors were not to be paid in

full as soon as the bank failed. An adequate fund would be one that would ultimately pay for all losses. It was provided that the maximum size of the Kansas fund should be $500,000, and that the fund was to be built up by assessing the average deposits.

It was provided that the annual assessment for purposes of creating the guaranty fund should be not more than one-twentieth of one per cent of the "average deposits". In computing the "average deposits" as a basis for the assessment, a bank was allowed to deduct its capital and surplus. This provision was made in order to encourage the accumulation of capital and surplus. The assessments were to be made annually until the fund equalled $500,000 after which time they were to stop until the fund fell below that sum. It was stipulated in the law also that when the fund became depleted, additional assessments of not more than one-twentieth of one per cent could be made provided not more than five levies were made in any one year.

The Kansas law provided that the fund should be held in state depository banks subject to the order of the Kansas Banking Commission.

Banks Eligible to Join Kansas System

It was provided in the law establishing the fund that only those banks that were at least one year old and had a paid-up and unimpaired surplus equal to ten per cent of their capital would be considered as being eligible to join the Kansas system except in places where there was no guaranty bank. The banks which were able to comply with these qualifications were to be

carefully examined in order that a bank in an unsatisfactory condition might be excluded from the benefits of the system. If the examination proved to be satisfactory, the bank had to deposit with the State Treasurer, as evidence of good faith, $500 for each $100,000 deposits. (This $500 could be in cash, national, state, or municipal bonds.) This deposit was not intended to take the place of the assessment for the fund itself, but merely evidence of good faith in becoming a guaranty fund bank. When this depository requirement was complied with in full, the bank commissioner of Kansas was empowered to issue a certificate stating that the deposits of the bank were guaranteed.

It was recognized by those who enacted the legislation for the Kansas system that a bank might wish to withdraw from the system in order to avoid an assessment to meet payments due from the fund. It was provided, therefore, that a bank could withdraw from the system at any time when it had paid in full its "quota" of the assessments made to pay losses from bank failures occurring within six months period after the date of the application to withdraw. When a bank had met satisfactorily all of the requirements of the law pertaining to its withdrawal from the guaranty system, the State Treasurer had to return to the bank the $500 deposit of cash or bonds held by the State as evidence of good faith.

Procedure When a Bank Failed

The procedure for paying the depositors in the Kansas

guaranty system was a commendable one. It avoided the placing of an unnecessary burden upon the banks of the State because of heavy losses, and at the same time it permitted the depositor to obtain his money almost immediately.

The law provided that the Commissioner of Banks in Kansas should take over the liquidation proceedings of closed banks. It was his duty to issue to each depositor of the closed institution a certificate of indebtedness equal to the amount of the deposit involved; these certificates were to bear interest at six per cent. (When the deposit for which the certificate was issued bore interest at a contract rate, the certificate rate of interest could not exceed this rate.) As soon as the funds or assets of the closed bank could be liquidated satisfactorily, they were to be applied to the retirement of the certificates outstanding. When the assets of the closed bank proved to be insufficient to pay all the depositors in full, the Commissioner of Banks was compelled to certify the balance due the depositors to the State Treasurer who then paid the balance from the guaranty fund.

The certificates of the closed bank were readily accepted by the depositors because they were in reality equivalent to cash. The banks of the State sought after these certificates eagerly because not only were they a good investment, paying a return of six per cent interest, but they brought new depositors to the banks purchasing them or accepting them as deposits.

The Failure of the First Voluntary Deposit Guaranty Plan

At the inception of the Kansas system, it proved to be very popular. Most of the larger banks and all the new banks established subsequent to the adoption of the plan became guaranty banks.

The following table shows the number of guaranty banks and non-guaranty banks in June 1913 as compared to the number in August 1923:[124]

	Number	Deposits
June 1913		
Banks Guaranteed	472	$ 71,040,906
Banks Not Guaranteed	446	42,707,937
All State Banks	918	$113,748,843
August 1923		
Banks Guaranteed	691	$181,088,518
Banks Not Guaranteed	381	63,412,082
All State Banks	1072	$244,500,600

Prior to 1920 only two guaranteed banks failed, and the depositors were paid $83,050 from the guaranty fund. Between 1920 and 1926, however, one hundred and eight banks failed and as they failed, certificates bearing interest at six per cent had to be issued to the depositors. The modified report of the State Bank Commissioner for the year 1926 showed the condition of the fund as of January 1, 1927:[125]

---

124 "Collapse of Bank Deposit Guaranty in Oklahoma and Its Position in Other States", Thornton Cooke, Quarterly Journal of Economics, Volume 38, No. 1, Page 121

125 "The Guaranty of State Bank Deposits", John G. Blocker, Bur. of Business Research, No. 11, July 1929 -- Page 27

Liabilities

Total Guaranty Certificates Outstanding (10,644,244.05) Less ($4,484,902.08) Certificates (Assets)	$6,159,341.97
Additional Liability, Accrued Interest on Guaranty Certificates (est.)	700,000.00
Additional Liability on Unfiled Claims of Member Banks Admissable to Guaranty Fund	1,967,830.00
Total Liabilities	$8,827,171.97

Deductions

Cash on Hand to Credit of Failed Guaranteed Banks Not Disbursed in Dividends ($681,853.98) and Estimated Recovery From Assets of Guaranteed Banks Not in Course Liquidation ($1,641,500.00)	2,323,353.08
Net Liability of Guaranty Fund	$6,503,817.99

Guaranty Fund Assets

Cash on Hand Available for Paying ($210,679.24) and Bonds Securing Guaranty Fund Pledged by Member Banks ($904,153.34)	$1,114,832.58

To make this breakdown complete, several banks brought suits in the State Supreme Courts to determine their liability to the fund. On April 10, 1926, a decision was handed down limiting the amount of the liability of each bank to the amount of bonds or cash on deposit in the Guaranty Fund. The state banks began to withdraw and forfeited their bonds to the average amount of $1600 each. On July 10, 1928, only forty banks continued to pay the guaranty fund assessments.[126]

The Kansas law provided that the depositors of failed banks should be paid in full in the order of the liquidation of the banks holding the deposits.

126 "The Guaranty of State Bank Deposits", John G. Blocker, Bureau of Business Research, Kansas Studies in Business, No. 11, July 1929, Pages 27-29

The State Supreme Court ordered the bonds held to be sold and the depositors paid. As a result, twenty-six failed banks were fully liquidated, but there was only enough money left from the liquidation proceedings to pay in full the depositors of nine of the banks. The tenth and eleventh banks were liquidated on the same day so the remaining funds were divided equally among the depositors of the banks.

On February 18, 1929, the situation was as follows:

Certificates Outstanding in Hands of Depositors	$13,595,249.19
Dividends Paid Depositors	6,419,935.64
Net Liability of Guaranty Fund	$ 7,175,313.55

During the twenty years of existence of the guaranty fund there were two hundred and four bank failures in the State of which one hundred and thirty-four were guaranty banks.[127] While the law was in force less than fifty-eight per cent of the state banks had joined the system, but seventy-two per cent of the total bank failures in the State had been guaranty banks. The plan cost the bankers $2,658,000.[128]

The number of guaranteed banks failed each year is shown below:[129]

Year	Number
1910-1919	1
1919	1
1920	2
1921	8
1922	15
1923	25
1924	11
1925	15
1926	33
1927	19
1928	3
1929	1
Total	134

127 Ibid., Page 29
128 "How Kansas Bank Deposit Insurance Failed to Insure", Executives' Magazine, November 25, 1933, Vol. XVII, No. 6, Page 12
129 "The Guaranty of State Bank Deposits", John G. Blocker, Bureau of Business Research, No. 11, July 1929, Page 29

Five of the guaranteed banks which failed paid depositors in full out of their own assets. Twenty-nine additional banks paid in full their deposits, two of which were paid partially from the guaranty fund.

At the repeal of the law on March 14, 1929, thirty-one State banks were still actively participating in the guaranty system. These banks had paid all of their assessments to that time. The bonds and money held for the benefit of deposits paid in by these banks totalled $24,000 which was deposited with the State Treasurer as security for assessments. This was returned to these banks.

THE TEXAS SYSTEM[130]

In 1909 the State of Texas passed a law creating a deposit guaranty system. The Texas system is a "compulsory optional plan" under which all trust companies, banks, and trust companies with banking and discounting privileges were obliged to protect all deposits subject to check in one of two ways. A bank could elect to protect depositors by complying with the requirements of the "Depositors' Guaranty Fund" or "Depositors' Bond Security System".

The Texas law provided: "Every state bank and trust company must elect to become a 'Guaranty Bond' bank or an 'Guaranty Fund' bank, and must hold a certificate from the Bank Commissioner stating the method elected and in force. If a bank advertises that its deposits are secured by any other means, or by the State of Texas, that bank is guilty of misdemeanor and

130 "The Guaranty of Bank Deposits, T. B. Robb, Houghton-Mifflin (1920), Pages 146-149

punishable by law."

The Depositors' Guaranty Fund had these provisions regarding compliance with and administration of the law. In order to protect deposits under the Depositors' Guaranty Fund each bank had to meet these requirements: Each bank and trust company had to pay into the State Banking Board as an initial payment a sum equal to one per cent of its average checking deposits for the preceding year. Annually thereafter each bank had to pay an assessment equivalent to one-fourth of one per cent. When the fund amounted to $2,000,000 there could be no more assessments until the fund was depleted. Upon the depletion of the fund there could be emergency assessments of not more than two per cent of the average checking deposits of any one year.

The law creating the Deposit Guaranty Fund provided further that twenty-five per cent of each assessment had to be paid to the State Banking Board while the remaining seventy-five per cent could be credited on the books of the bank. A new bank was obliged to pay three per cent of its capital and surplus into the fund, the amount to be adjusted at the end of the year on the basis of average daily deposits.

It was provided that only those banks and trust companies that were solvent could be admitted to the Depositors' Guaranty Fund of which the Banking Board was the sole judge. The national banks were allowed to participate.

The depositors of the failed "Guaranty Fund Bank" were to be paid cash at once in full from the cash in the bank and the

guaranty fund. The guaranty fund had a first lien on the assets of a closed bank. There were no provisions for the issuing of interest-bearing certificates.

The second method of securing deposits in Texas was by means of the "Depositors' Bond Security System". The banks and trust companies electing this system had to file with the Bank Commissioner of the State of Texas on the first day of each year "a bond policy of insurance or other guaranty of indemnity equal to the amount of its capital stock, which bond or policy insures to the benefit of the depositors of the bank."[131] It was provided that the Bank Commissioner should be the sole judge of the security offered and he was empowered to accept or reject such security.

Under the Bond Security plan the Commissioner was to take charge of a bank when it failed and then proceed to liquidate the bank. It was also his duty to notify the guarantors or those obligated in the bond, and sixty days thereafter the bonds became due and payable.

The State law provided further that when an obligor in the bond was a Texas Corporation and refused to pay, its charter was to be forfeited; and when any foreign corporation was obligor and refused to pay, it was to be denied the privilege of transacting business in the State of Texas. If after ninety days the payment was still due, the Attorney General had to bring suit.

The Texas laws designed to protect depositors had another provision that was unusual. It was provided that when a bank

131 "The Guaranty of Bank Deposits", T. B. Robb, Houghton-Mifflin (1920) -- Pages 149-150

had deposits which exceeded six times the capital and surplus of the bank it had to file additional security equal to the amount of the excess.

In order to throw additional safeguard around the deposits of its citizens in State banks, the State of Texas passed other stringent laws designed to make for more careful management of depositor's money. It was provided that no state bank or trust company could own more than ten per cent of the capital stock of any other banking corporation unless the purpose of such a holding was to secure itself against loss. Penalties for deplacation were provided. Furthermore, the state limited the amount of indebtedness of any director or officer to the bank. Finally, the State of Texas made the first attempt to establish a definite arithmetical relationship between deposits and the capital of a bank (see Page).

It is interesting to note that on March 1st, 1920, the Commissioner of Banks announced that the next assessment would cause the amount in the Depositor's Guaranty Fund to reach the $2,000,000 legal limit and, therefore, after that date no more assessments could be made until the fund became depleted in accordance with the statutory requirements.

The Results of Deposits Guaranty in Texas

The Texas law was formally repealed by the State Legislature in 1927 following its insolvency in September 1926.

During the first ten-year period of operation of the Texas system seven hundred and fifty state banks entered the system.

During this period the system enjoyed great success. From January 1, 1910, to November 1, 1920, nineteen guaranty banks failed. In order to satisfy the depositors of these banks $881,594.85 had been withdrawn to pay the depositors, which sum was an average of $50 a year to each of the one thousand or more member banks during the period. The plan was, therefore, very popular.[132]

However, the depression of 1920 and the six-year period following brought disaster to the guaranty fund. During the period from 1920 to 1926, one hundred and fifty guaranty fund banks failed in Texas. Of these some fifty-two were reorganized but the depositors of the others cost the other solvent banks of the system $19,000,000 of which $4,000,000 was recovered from the failed banks. The stockholders and depositors of the solvent banks became aroused and some of the state banks became national banks.[133]

In 1925 the guaranty fund law was amended and permitted the state banks to get relief from liability to the fund by furnishing bond to the amount of the capital stock of each bank. All the banks except twenty-four withdrew from the system; i.e. six hundred and fifty-four changed to the bond plan, and eighty-eight became national banks. The twenty-four banks remaining in the system were too weak to furnish bond and were obliged to remain in the system to hold deposit accounts.

The guaranty fund became insolvent on September 29, 1926. There was nothing left except formal sanction of the breakdown

---

132 "The Guaranty of State Bank Deposits", John G. Blocker, Bureau of Business Research, Kansas Studies in Business, No. 11, July 1929 -- Pages 39-40

133 Ibid.

of the system and on February 11, 1927, the law was repealed.

In 1929 there were nine banks with deposits of $900,000 remaining unpaid.

After the repeal of the law many national banks came back into the system, and it was reported by the Banking Department that the banking conditions of the State of Texas improved greatly subsequent to the removal of the deposit guaranty law.[134]

WASHINGTON PLAN[135]

The State of Washington inaugurated a voluntary deposit guaranty plan in 1917. It was provided that a guaranty fund amounting to one-half of one per cent of the average annual deposits eligible to guaranty should be created. The contributions of the banks under the law were not to be withdrawn from the banks, but charged to the guaranty fund on the books of the bank. Surprisingly this law did not provide that the amount charged to the guaranty fund should be charged against the income of the year the fund was established, nor did the law make any provision for the amortization of this guaranty fund contribution. It was inevitable that the banks would have to bear the expense when losses occurred, and these were likely to occur when the banks would be least able to stand the assessments.

To secure the payments to the fund each bank coming under the system had to deposit securities with the Guaranty Fund Board of the State amounting to one per cent of the eligible deposits.

---

134 "The Guaranty of State Bank Deposits", John G. Blocker, Bureau of Business Research, Kansas Studies in Business, No. 11, July 1929, Page 40

135 "Quarterly Journal of Economics", Volume 36, No. 2, February 1922 -- Pages 350-356

In 1921 this law which passed in 1917 was changed. The amount of the guaranty fund was increased to one per cent of the eligible deposits, but still remained merely a book transaction between a deposit guaranty member bank and the Guaranty Fund Board. In addition, the deposited securities were returned to the member banks.

A second fund was created which was known as a "Contingent Fund" to be accumulated by annual assessments not exceeding one-tenth of one per cent of the average deposits in member banks.

It was provided that the banks should make contributions to the Contingent Fund in cash from which the expenses of the Guaranty Fund Board were to be paid. (No salaries were paid the members of the Board.) It was estimated that these contributions of one-tenth of one per cent would be sufficient to build a fund of the proper size in a period of thirty years provided there were no failures.

Bank Deposit Guaranty in the State of Washington

The deposit guaranty system inaugurated by the State of Washington failed after a duration of only four years.[136]

The law became effective on March 10, 1917, and in 1920 there were one hundred and sixteen banks and four branches operating guaranty banks. During the operation of the system only about thirty-nine per cent of the banks in the State joined it and the total deposits subject to protection was $65,000,000.

On July 1st, 1921, the Scandinavian-American Bank failed. This failure involved $15,834,624 in deposits.[137]

136 "The Guaranty of State Bank Deposits", John G. Blocker, Bureau of Business Research, Kansas Studies in Business, No. 11, July 1929 -- Page 46

137 "Quarterly Journal of Economics", Volume 36, No. 2, February 1922 -- Pages 350-356

At the time of this bank failure, the guaranty fund amounted to only $320,908. The Guaranty Board of the State made an assessment of one-half of one per cent of average daily deposits, and at the same time asked the banks to turn over the per cent already credited to the fund on the books of the banks. These assessments made available a sum approximating $500,000, and a levy of one-tenth of one per cent of average daily deposits for the contingency fund added $50,000. An additional special assessment of one-half of one per cent added $250,000 more.

The assets of the Scandinavian-American Bank netted about seventy-five per cent of face value when liquidated, which sum when added to the amount in the guaranty and contingency funds made possible a payment to depositors approximately eighty-five per cent of claims. This failure broke down the system. The guaranty fund law provided that all banks could withdraw from the system by giving notice in writing to the Secretary of the Guaranty Fund Board six months in advance of withdrawal provided all payments, assessments, and obligations to the fund had been met. All the banks withdrew, and the law became inoperative before January 1st, 1922. It was formally repealed by the State Legislature in January 1929 effective June 11, 1929.

Chapter Three

THE RESULTS OF STATE BANK DEPOSIT GUARANTY

Significance of Historical Study

The study of the attempts at bank deposit guaranty by each of the states which has undertaken to protect depositors against loss when banks fail for one cause or another is valuable only when the laws themselves and the facts pertaining to their operation are interpreted.

Each of the experiments put into operation by the western states ended in disaster, and although each particular state guaranty system failed in its operation because of particular circumstances and events peculiar to the individual state, there were factors which helped to cause these failures which were common to all the guaranty programs.

The writer has reviewed briefly the history and outcome of each of the deposit guaranty systems. It is the purpose of this chapter to derive some conslusions of a general nature regarding the guaranty of bank deposits by states. These conclusions are of value in formulating an opinion on the federal program for insuring bank deposits inaugurated a little over a year ago.

The Political Factor

It has been shown that the state deposit guaranty systems had their origins in the political campaigns following the bad crops of 1887 and depression of 1893-1897. The losses experienced by the public because banks failed, and the concern aroused

by the people regarding the ability of bankers to care for their savings and working funds, aroused politicians to seize upon the problem as one which could be remedied by legislative action and which, therefore, was a good political issue for attracting votes. For example, even after other states were having their difficulties in making state deposit guaranty work, as well as his own, the Governor of South Dakota campaigned successfully on the deposit-guaranty issue.

The politicians and bankers fought over the issue, and it eventually became the subject of discussion when national party platforms were being formulated. The politicians sincerely believed that they could legislate public confidence into the banking system, and the bankers fought the idea because they knew that public confidence was a matter of confidence in bank management, and in the end the honest banks would just have to pay a big bill to cover the practices of dishonest managers.

The President of the Kansas Bankers' Association, Mr. W. M. Peck, stated at a meeting of the Association in 1909: "There remains but one other subject concerning us bankers which I desire to speak of. In Kansas we have had our grasshoppers, our long unbroken droughts, our be-whiskered Peffer, our Mary Ellen, our Carrie Nation, and now we have the latest and greatest of them all -- our bank guaranty law."[138]

Banking is a business which must be exercised with the greatest of care, and the success of any bank in the last analysis rests with its management. It is impossible for the

[138] "Deposit Guaranty in Kansas", F. S. Wetlock, Bankers' Magazine, Volume CXIII -- Pages 318-319

legislators to instill honesty and judgement in the minds of men. The laws of a state can be designed to place certain safeguards on the operation of a bank, and such laws can serve only as guide posts and impose penalties for dishonest conduct. On the other hand, the action of the public can force dishonest bank managers out of the banking business. When a depositor knows that the safety of his money depends upon the safe management of his bank, he is going to exercise whatever degree of care in selecting his bank that may be within his power. The bank that enjoys a reputation for sound management, fair dealing, and conservative policies is going to get the business.

When the state sets up a deposit guaranty law it destroys all of this and virtually says to the public that one bank is as good as the other, and that all managers are equal in ability. Not only does this destroy the necessity for banks exercising their best judgement to get business, but it encourages dishonest and speculative practices because the banker knows his depositor, who is aware that his money is not going to be lost, will not question his practices.

Sound banking is not wholly a matter of legislation; its achievement is gained in just the same way as is the sound management of any business.

The decisions regarding legislation which pertain to banking should be excluded from the political arena; it is difficult for men whose experience and training is broad to determine what path to follow. It is even more impossible for politicians whose

interests must be varied and whose opinions of public matters are interpreted in the light of what they think the majority want, rather than what seems best for all concerned.

In speaking of the Kansas situation, Mr. Wetlock says:[139] "The guaranty act contained nothing designed to prevent losses, its aim was to repair losses .... The situation in Kansas was further complicated by the fact that the guaranty act was drawn and administered not by skilled actuaries and bankers, but largely by persons chosen for political reasons."

Effect of Deposit Guaranty Upon Banking Practices

One of the most unfortunate consequences of state deposit guaranty was the stimulus it afforded to dishonest banking. It has already been pointed out that the successful management of any banking business depends upon the business integrity of the bank's managers. In the State of Oklahoma it was found that bank loans were made in certain banks without proper regard for the security for the repayment of the loans. In discussing the causes for the failure of the Columbia Bank and Trust Company of Oklahoma City in Oklahoma, Mr. Robb states:[140] "The main reason was the fact that the Columbia's president was a member of a clique of plunging oil and real estate speculators, and the rapidly accumulating deposits of the Columbia were used to lubricate their ventures."

He states further:[141] "Among the uncollected assets were five personal notes of W. L. Norton amounting to $211,563.69. These notes probably represent loans from his bank to assist him

139 "Deposit Guaranty in Kansas", F. S. Wetlock, Bankers' Magazine, Volume CXIII -- Page 294
140 "The Guaranty of Bank Deposits", T. B. Robb, Houghton-Mifflin (1920) -- Page 47
141 Ibid., Page 50

in caring for his oil paper when it was thrown out of national banks."

In discussing the Kansas system, Mr. Wetlock states:[142] "The plan held in principle that deposits would be attracted by reason of membership in the guaranty system, rather than on the basis of skillful, conservative banking. The principle that banking is a highly specialized activity was ignored."

It is a wrong system which allows depositors to regard all bank management in the same light. Just as no two businesses are managed equally well, no two banks are equally well managed. Some banks are bound to avail themselves of the opportunity to insure depositors money in a system when depositors have doubts about their security. In the end it is the honest banker who must pay the bill. The solvent banks are assessed to pay the losses of those failing. Not only do the honest bankers fail to get credit deserved for their conduct by enjoying the confidence of the public, but they must pay for the misconduct of those who carry on illegitimate and unsound practices. The system of guaranty in all of the states was to assess going concerns to pay the losses of those whose operations had ceased because of dishonest practices.

The Growth of Deposits Under State Guaranty Systems

It is pointed out by the Economic Policy Commission of the American Bankers Association that the deposits of state banks in the guaranty group were inflated to a considerable degree. Such inflation was caused in part by the false public confidence

142 "Deposit Guaranty in Kansas", F. S. Wetlock, Bankers' Magazine, Volume CXIII -- Pages 291-294

created in guaranty banks as compared to the non-guaranty banks.[143]

During the period from 1910 to 1920 the boom of banking under the guaranty laws reached its heights, creating the situation which existed on the eve of the reaction which took place in every system in 1920. In seven guaranty states in 1910 the aggregate deposits amounted to $400,100,000. By 1920, these deposits had grown to $1,468,600,000, an expansion of $1,068,500,000 or two hundred and sixty-seven per cent. In this same period the deposits of national banks in the same states grew from $336,400,000 to $966,800,000, an expansion of $630,000,000 or one hundred and eighty-seven per cent. The deposits of state non-guaranty banks increased one hundred and thirty-four per cent.

In 1920 the reaction against the weak banks set in. In June 1920 there were 5,306 banks in the States of Oklahoma, Kansas, Nebraska, Texas, Mississippi, South Dakota, and North Dakota. During the next ten years 1,624 of these banks closed their doors. This number was 30.6 per cent of the banks in these states. During the same period only 18.2 per cent of the banks in the forty-one non-guaranty states suspended operation. The guaranty group of states, comprising less than fifteen per cent of the states of the country and containing twelve per cent of the people of the nation and twenty-five per cent of the banks, contributed thirty-six per cent of the bank failures in the nation.[144]

There can be no question but what the unsound expansion of deposits and loose banking practices encouraged by the guaranty

143 "The Guaranty of Bank Deposits", Economic Policy Commission, American Bankers Association, Pages 38-39

144 Ibid., Page 39

laws contributed much to the conditions which brought about this situation. These states were a weak spot in the nation's banking structure.

The rapid growth of deposits indicated by the statistics stated in the preceding paragraph is conducive to unsound expansion of loans. A banker who sees his deposits increasing rapidly is forced with the necessity of putting this money to work or investing it. A rapid expansion of loans is conducive to unsound expansion. There is a tendency to be over-anxious to lend money on ventures that would not justify loans in a period of normal growth of bank deposits. A bank cannot operate and have money idle. To this situation was added the boom of war years when almost any project needing capital seemed bound to succeed. It is not surprising that the bankers in these western states found it difficult to collect loans when agricultural prices collapsed following the end of the war period. The income to the farm group was so curtailed that many good-intentioned farmers were forced into bankruptcy through over expansion of the production of a product for which the market was disappearing. Such instances only weakened the banks lending the money for this expansion. Deposits grew because the loans were expanding, and when the loans became worthless, the deposits were lost.

Deposit Guaranty on a State-Wide Basis

In each of the states setting up deposit guaranty systems the extent of the operation of the banks participating in the system was limited to the state's boundaries. It is possible

for a bank to lend money on distant ventures, but usually the majority of loans are made on projects close to home. The banker wishes to be in a position to judge the character of his borrower, and the worth of the project upon which the money is to be used. Furthermore, men are suspicious of that which they do not understand, and it is far easier to understand that which happens in one's own locality than something happening far away.

In the states having deposit guaranty systems the industries lacked any great degree of diversification. For example, the State of Nebraska is primarily an agricultural area; Oklahoma divides its energies between oil and agricultural production; Kansas is primarily an agricultural state; and so are the Dakotas.

A principle of sound banking is that a bank should have a degree of diversification among its investments and, therefore, one type of business will not be sufficiently important that the success or the failure of the bank will be determined by the success or failure of this business.

Mr. Robb points out that one very serious drawback to state deposit guaranty is the "concentration of risk" such as the risk which arises when a bank is located in an agricultural state and makes the majority of its loans within the state. A series of crop failures may shrink the assets of the bank to such an extent that serious bank failures will result.

A further factor is that the banker relaxes his vigilance in making loans because he realizes that the depositors will suffer no losses when he makes mistakes. Such an attitude is

comparable to the man who insures his house and proceeds to become less careful about fire than he was before he obtained the insurance, or the owner of an automobile who ceases to worry about its theft when it is insured against theft.

Chapter Four

OUTSTANDING WEAK POINTS IN STATE GUARANTY SYSTEMS

The test of the State Deposit Guaranty Systems came in the period following the World War when adverse economic conditions forced them to make payments of considerable sums of money to bank depositors of banks failing in rapid succession. It must be recognized that any bank failure is usually the result of a number of factors, both controllable and uncontrollable, and we have examined already in part some of the causes for the bank failures in the deposit guaranty states. It is now proper to ask whether or not the guaranty systems could have withstood the shock of these failures with better results, or if there were any factors which might have helped to make them more effective than they were.

There is no question that political influences helped cause the failure of the systems. Banks were insured whose condition was far from satisfactory. In Oklahoma the Bank Commissioner stated that it had been impossible to examine carefully many of the Indian Territory banks prior to their admission to the system. These banks had not been subject to regulation before this time and, undoubtedly, many of them should have been closed rather than allowed to operate. Furthermore, in the systems which provided for the payment of cash immediately upon the failure of the bank, the desire of the politicians to show how well the system could work, money was paid to depositors before the real condition of banks which had been closed could be

ascertained. Governor Haskell did this in Oklahoma. It would have been possible for him to issue certificates of indebtedness to the depositors pending an investigation, but his desire to champion his system led him to borrow money and pay cash when the first bank failed soon after the inauguration of the system.

The unwise lending of many banks stimulated an abnormal growth of commercial deposits which were guaranteed as soon as created; yet the banker had no security that the basis for the deposit created or note given as security for the loan would be repaid. This situation was bound to lead to catastrophe when customers found that they could not repay loans. It was a one-sided affair. The banker was not protected, but the depositor could claim the amount of his deposit or have it applied as part payment for his loan when the bank was liquidated.

The plan of allowing banks to maintain the assessments as book credits for the guaranty fund was unsound. The banks had the money and when banks failed in rapid succession, involving many millions of deposits, it was extremely difficult for the remaining solvent banks to make available to the guaranty fund the amount of cash credited on its books. Many solvent banks were almost forced into insolvency by these assessments. The State should have collected all of the assessments periodically instead of allowing them to accumulate in banks.

Another weakness of the guaranty systems was the failure to discriminate between banks as to risks involved. All banks paid the same rate. If banks had been obliged to pay insurance rates

or assessments in accordance with the degree of liquidity, or quality of loans made instead of on the basis of "inflated" average daily deposits, there would have been greater care exercised in the management of banks, an elimination of many unsound institutions, and thereby less failures chargeable to the system.

The failure to provide adequate banking laws in many states hampered deposit guaranty in that the banks were allowed to operate as guaranty banks when they should have been excluded. Laws restricting the extension of the number of banks, laws limiting deposits to a certain multiple of the amount of each bank's capital, and laws providing for elimination of the "speculative" investments would have helped.

Another weakness was the power given to the banking departments in some states allowing them exclusive power in determining the establishment of new banks, the determination of interest rates payable upon deposits insured, etc. When it is recognized that such supervisors were politicians it is not to be wondered that an unsound expansion of banks took place, and that bank supervision was far from satisfactory.

The laws were put into operation too soon after adoption and provided for the payment of depositors too quickly. The depositors of many banks were insured against loss of their money before the states had time to build up adequate reserves to stand the shock of heavy losses. For example, the State of Washington system was bankrupt almost as soon as it got under

way. Furthermore, depositors should have been issued certificates backed by an adequate reserve and the possibility of a fair and orderly realization upon the value of the assets of closed banks would have been accepted readily and would have given the systems more chance to get headway. Bankers would have been willing to give depositors money for the certificates thus causing them no inconvenience, and liquidation proceedings would have been far more satisfactory.

The guaranty of bank deposits on a state-wide basis was a fundamental weakness of the state guaranty plans. The diversity of business and the number of banks was too limited. This made a distribution of risks impossible. It has been pointed out that this weakness can be overcome by a national guaranty system. Such a conclusion is not substantiated by studies made (see Pages 183-188).

There was no real scientific procedure in the setting up of the state guaranty plans. Little knowledge of losses from bank failures in any of the states was available, and there was no attempt made to classify the risks which were being insured according to such figures.

Chapter Five
State Laws Protecting Deposits in Savings Banks

The States of Massachusetts, Wisconsin, and New York have all adopted laws protecting depositors in savings banks located within their boundaries. Since these plans do not include other state banks, they cannot be compared with the guaranty plans put into operation by the eight western states. Furthermore, their significance in the history of deposit guaranty cannot be known until they have enjoyed a few additional years of existence. However, the writer does not think that a treatment of the history of deposit guaranty in the United States would be complete without some mention of these plans and, therefore, a brief outline of the important features of each of the systems is presented.

The Massachusetts plan is not strictly speaking a deposit guaranty system in that a corporation was created to provide a means of rapid liquidation for long term investments when the occasion arose. The Wisconsin and New York plans, on the other hand, created a fund for insuring deposits.

Mutual Savings Central Fund Incorporated

Massachusetts incorporated its Mutual Savings Central Fund Incorporated in 1932 for a period of five years. Unless the charter of the Corporation is renewed, deposit guaranty in Massachusetts for savings banks will end.[A]

The Mutual Savings Central Fund Incorporated is not a guaranty fund scheme as are the Wisconsin and New York plans. It is a corporation, the purpose of which is to provide liquidity

[A] Massachusetts General Laws, Chapter 44, Acts of 1932, Section 1-8

for the mutual savings banks of the Commonwealth. The purpose is stated in the 1932 Acts, Chapter 44, as follows: "It shall be the purpose of the Corporation to assist such member banks when they are temporarily in need of cash or hold investments which cannot readily be liquidated by making loans to them or any of them secured by pledge of mortgages or other securities legally held by such member banks."[B]

This Mutual Savings Central Fund is administered by officers consisting of a president, vice president, treasurer, clerk and board of fifteen directors. The officers are elected by the directors and the directors attain office by member bank nomination and election. Each member bank is entitled to one vote in each election for each ten million dollars of deposits. The directors are elected on the following basis: Two from each of the Counties of Essex, Worcester, and Middlesex; five from the County of Suffolk; one from the County of Hampden; two from a district composed of the Counties of Barnstable, Bristol, Dukes, Nantucket, Norfolk, and Plymouth; and one from a district composed of the Counties of Berkshire, Franklin, and Hampshire.

The directors of the Corporation are instructed to obtain working capital for the Fund by assessing each mutual savings bank in the State for a deposit in cash of not more than three per cent of its deposits, excluding club deposits as shown by its latest statement. The directors were authorized by the law creating the Fund to call for five per cent of the assessment allowed at the first meeting of the Corporation. In exchange

[B] Massachusetts General Laws, Chapter 44, Acts of 1932, Section 1-8

for the assessment paid the member bank was to be given a certificate of deposit. These deposits are non-returnable except when each member mutual bank receives an equal amount.

The Corporation is empowered to borrow money for its purposes on pledge of its own assets. In addition the directors are empowered to declare dividends upon the deposits in the fund.

When the fund is no longer necessary for its purposes, it is provided that its affairs may be brought to an end.

The Wisconsin Law Protecting Savings Bank Depositors

A brief summary of the important points in the Wisconsin law follows:[C]

(1) All savings banks organized in the State subsequent to the year 1932 must contribute to the creation of a guaranty fund. (See Footnote)

(2) The initial contribution of all such banks must be $5,000 in cash, and such other contributions as may be deemed necessary by the Commissioner of Banks to preserve the solvency of savings banks in the State of Wisconsin and to render it safe for them to continue in business.

(3) The Wisconsin fund for savings banks may not be encroached upon prior to the liquidation of any savings bank until it exceeds ten per cent of the amount due depositors except, however, to repay contributions made by the incorporators or trustees.

Footnote: According to the Literary Digest for June 10, 1933, the Wisconsin Plan suffered a $6,000,000 deficit within six months of inception.

[C] State of Wisconsin (Chapter 222), The Banking Law, Rev. March 1, 1934

(4) Contributions made to the guaranty fund by the incorporators or trustees plus interest thereon from the date of contribution thereof at six per cent per year not compounded may be repaid pro rata to the contributors from that portion of the guaranty fund created from earnings whenever such payments will not reduce the guaranty fund below five per cent of the total amount due depositors.

The New York Deposit Guaranty Law

The State of New York adopted its guaranty fund law in 1934. It provided that seventy-five or more banks in the State having fifty per cent of the deposits of all the deposits liabilities of the savings banks in the State might enter into an agreement subject to the approval of the Superintendent of Banks to create a fund and make contributions to such fund for the purpose of insuring deposits. The fund is to be handled by a corporate trustee or board of trustees composed of individuals who are trustees of the mutual savings banks of the State of New York.

The law became operative and includes one hundred and thirty-five out of the one hundred and thirty-eight savings banks of the State, having ninety-two per cent of the deposit liabilities of the savings banks of the State.

The law does not state the amount of contribution that must be paid by the member banks. It is covered, however, by the agreement which states that each member bank must pay to the fund one-fifth of one per cent of its deposit liabilities as shown by a statement to be submitted to the trustee. Thereafter

on ten days notice the trustee may call for an additional payment of one-fifth of one per cent. When both payments have been made and the fund is insufficient to meet an emergency, the trustee may assess the member banks additional amounts that will not exceed two-fifths of one per cent of their deposits.

An additional one-fifth of one per cent may be called for by the trustee by a vote of two-thirds of the member banks representing seventy-five per cent of all member bank deposit liabilities.

The total assessments that may be called for amount to one per cent of deposits, and this is the maximum that may be called for in any one year during the term of the agreement.

Each year member banks are required to file with the trustee a statement of their condition and at the same time they must pay to the fund an amount equal to one-tenth of one per cent of their deposit liability.

It is contemplated that the fund will become equal to approximately $100,000,000 , or two per cent of the total deposit liabilities of all banks.

When the fund exceeds five per cent of the total deposit liabilities of member banks, but by not less than a million dollars, the trustees are required to make dividend disbursements to all banks in the amount of the excess.[D]

[D] "Mutual Savings Banks Insurance Funds", Philip A. Benson, American Bankers' Association Journal, August 1934, Pages 18-19

P A R T IV

PART IV

POST-WAR DEVELOPMENTS LEADING TO FEDERAL BANK DEPOSIT GUARANTY

Introduction

The "Banking Act of 1933", so-called, made provision for the establishment of a corporation to guarantee deposits on a national scale. The Act was passed by the Seventy-third Congress as a compromise measure to pave the way for the passage of several measures designed to remedy the banking ills of the country which were part of the cause for the collapse of the banking structure in February 1933, and which it was found could not be remedied by temporary banking legislation treating only the surface difficulties.

At the time of the enactment of this deposit guaranty legislation by Congress there was almost unanimous opposition on the part of the country's leading bankers, as well as the Administration itself. However, the Bill became law largely as a result of an impetus given by the emotional wave which swept the country following the investigations of investment bankers by a Senate Committee since this Bill had incorporated in it some remedies for these ills.

Before presenting the provisions of the Banking Act of 1933 relative to the guaranty of bank deposits, it is desirable to trace briefly the events which led up to the situation making this legislation possible and which influenced the character of the legislation.

Chapter One

The Collapse[145]

The effects of the World War upon the banking structure of the United States began to be felt in the period directly following the depression in 1920-1921. The unsound and inflationary financing of the War had left the banks of the country in a weakened condition.

Beginning with the year 1922 bank failures became increasingly alarming and indicated a disintegrating system. For the most part these bank failures were not regarded as being important. Bankers and the public alike throughout the country dismissed them by supposing that they were merely the result of unsound credit expansion in a particular locality. The number of bank failures as reported by the Comptroller of the Currency is given in the following summary review of the period 1921-1930:[146]

	All Banks	National Banks	State Member Banks	State Non-Member Banks
Suspended	6,968	925	257	5,786
Reopened	797	98	27	672
	6,171	827	230	5,114

Bank failures spread very rapidly throughout the states in the middle west, and still practically no attention was paid to the situation. This attempt to overlook the whole situation was well evidenced in the formation of the National Credit Corporation to provide mutual aid among banks in 1931. In this same year the number of bank failures amounted to approximately

145 "The Banking Situation" (American Post-War Problems and Developments), H. Parker Willis and John M. Chapman, Columbia University Press (1934) -- Pages 3-20

146 Ibid., Page 7

2,300 banks, or about fifteen per cent of all banks in number. Such a condition existent in the banking world should have been just cause for a thorough house-cleaning in the banking system, but instead it served as an impetus to give the situation additional relief.

In January and February of 1932 there was created the Reconstruction Finance Corporation. This organization made extended loans to banking institutions in need of assistance, and by the close of the year 1932 this Corporation had loaned banks of the country approximately $850,000,000. The banking conditions of the country were not being corrected by these loans, but were merely being allowed to continue in an unhealthy condition which was surely doomed to disaster in the end.

Senator Carter Glass, the Chairman of the Senate Committee on Banking and Currency, was awake to conditions and proposed a bill that would help the situation as early as 1931. This so-called "Glass Bill" proposed many banking reforms that were sorely needed, and provided also for the speedy liquidation of failed banks which would avoid the necessity of making the depositor wait for his money. This Bill was not acted upon by Congress in 1932, and it was apparent to those in touch with conditions that the banking structure of the country was headed for a collapse unless some substitute remedies could be brought forward. The banks of the country were becoming less liquid and thus were less and less able to meet the demands for funds on the part of the depositors and, finally, many of these banks

found themselves unable to supply capital to business firms dependent upon banking accommodations for their existence.

The seriousness of the situation in the banking world in early 1933 caused many to wonder how and when the collapse of the banking structure would appear. It seemed to be right at hand, and when it became apparent that Congress intended to provide no relief beyond its previous measures, there seemed to be left only the problem of guessing the form of breakdown that would evidence itself first.

What was likely to happen had been pointed out by the State of Nevada in October of the previous year (1932) when the Governor declared by official proclamation that all State banks were exempt from paying deposit liabilities for a period of twelve days.[147] This move gave official sanction to a condition in banking that was far from desirable. It was the first step of this sort ever taken in the history of the country. This action was followed by a short holiday for banks in Louisiana in early February when the banks in New Orleans had to be helped by the State.

On February 14, 1933, the State of Michigan dealt the most telling blow. The Governor of Michigan closed the banks of the State for a period of eight days, and at the end of that time extended the holiday for another four days.

This bank holiday idea spread rapidly among the states and took the form of a compulsory holiday in some states, while in other places the locality had the option of closing its banks,

147 Ibid., Page 9

refusing to pay depositors or not.

The bank holiday idea was tolerated by the American public because it felt that such action was for the interest of all concerned. It is surprising, however, to find a people passively accepting a condition under which it could not withdraw from banks that which it had been educated to expect as an immediate payment subject to the suspension or receivership of the bank.

The bank holiday idea spread rapidly throughout the country, and by March 1933 the banks in thirty-seven states had been affected in some manner by it. In seven of the states affected, there were actual bank holidays.

Subsequent to these holidays in these states, the legislatures met and enacted legislation in a speedy manner to relieve the tenseness of the situations and to provide people with money. The legislation enacted was of three kinds:[148] (1) Some states forbade by executive order the payment of funds to depositors, and this action was legalized by the legislatures. (2) In other states the legislation provided for the payment of depositors in proportion to the liquidity of the deposits, this liquidity to be determined in some cases by the banks and in others by the banking departments of the respective states. (3) In still other states the amount of deposits that might be withdrawn by any one individual was limited, thus establishing a degree of liquidity to be considered uniform for all the banks in the state.

The passing of the laws was complicated to an extent by the lack of power of the state to control the national banks located

[148] Ibid., Page 10

within their borders. To remedy this, Congress passed an act in February 1933 giving the national banks power to co-operate with the authorities of states in meeting the local conditions. In addition, the Comptroller issued a proposed draft of a uniform act and recommended it to the state legislatures desiring to take action in favor of national banks within the state's territory. (In some localities the national banks wished to remain open to demonstrate their liquidity and solvency to the public, and in instances these banks had to be coerced into closing their doors for the protection of the less fortunate banks in the community.)

The bank holidays and suspensions of payments to depositors made themselves felt particularly in the conduct of business. There was a lack of currency to meet pay-rolls, etc., and it became necessary to adopt some local medium of exchange. Substitute money made its appearance in the form of clearing house certificates, as well as tokens and other mediums of local effectiveness only. As the holiday spread, the intercommunity trading ceased. A national currency was lacking, and the difficulties of business grew as the days passed without definite action of a national sort. The climax came when on March 5, 1933, President Roosevelt issued his proclamation declaring a general banking holiday to last for four days.

Chapter Two

TEMPORARY RELIEF MEASURES

To meet the situation squarely, it was essential to institute immediate relief measures, the most pressing being a provision for a medium of exchange that would enable business to carry on its regular transactions.

The means for providing the temporary currency or circulating media for business was the first task of the new Administration. There were several ways to do this:[149] It was possible to allow the continuation of local currencies under the direction of local bankers' associations; it was possible to issue a national emergency currency; the Federal Reserve Banks could be utilized to furnish the medium of exchange; and emergency currency could be issued within the Reserve system. It was decided to use the Federal Reserve machinery to provide the currency. On the ninth of March a bill designed to meet the emergency was presented to Congress. This measure ratified the national holiday action taken by the President, and authorized him to take such measures again, when the situation warranted, as well as giving him power to prevent hoarding.

The measure provided also for the issue of notes to be known by a title of a former issue, "Federal Reserve Bank Notes". These new notes were like the former issue in requiring no specie backing, but unlike them in that any assets approved by the Federal Reserve Banks could be used as collateral for their issue. To provide for those banks which would not be able to

[149] Ibid., Page 21

reopen at the end of the holiday period, the Act provided for the appointment of conservators whose function would be to take over these banks. Finally, the Bill provided for supplying new capital to the national banks which would have to be reorganized before being allowed to continue their operations. Such new capital was to be provided by the sale of preferred stock to depositors of these banks who would convert their claims against the bank into this stock on a basis to be worked out, or by the sale of the stock to the public at large who might wish to help out the banks being reorganized. Moreover, it was provided that the Reconstruction Finance Corporation might supply some of the needed capital upon meeting specific requirements.

To determine what banks should be allowed to reopen and which ones should be closed was a problem that could not be answered because of inadequate information in the hands of the Comptroller regarding the solvency of such institutions. Moreover, it would have required months to examine these banks and determine which should be closed for all time. The solution to this problem resulted in a classification of banks into three general classes:[150] (1) Those authorized to open without reservation and with the obligation to pay their depositors in full upon demand. This group comprised only nine or ten thousand [illegible] banks. (2) Those institutions which were allowed to operate under their own management, but which could not allow withdrawals on an unrestricted basis. (In the case of each depositor, his withdrawal was not allowed to exceed a certain

[150] Ibid., Page 23

percentage of the total amount he had on deposit with the bank. There were about five thousand banks in this class.) (3) Banks in the hands of conservators which were subdivided into two classes: (a) Those banks placed in the hands of the conservators but which could receive deposits subject to demand at the will of the depositor to be kept in cash or government bonds, and not to be mingled with the other funds of the bank. There were between three and four thousand banks in this classification. (b) Those banks which were finally and definitely closed, and these numbered about one thousand in all.

Chapter Three

INADEQUACY OF RELIEF MEASURES

The closing of these banks of the United States had the effect of contracting considerably the amount of money available to the business world for carrying on its transactions. At the beginning of March there had been about fourteen billions of demand deposits and twenty-four billions of time deposits subject to withdrawal. This had dwindled to ten and fourteen billions respectively; i.e. from four to six billion dollars in deposits had been rendered unavailable to depositors. When the total of deposits only partially available to depositors was added to this, it meant that about fifty per cent of the deposits available to depositors prior to the holiday were not available at the end of March.[151]

After a few weeks of operation other banks which had been allowed to resume business were closed and conservators appointed. This tended to destroy the public confidence in banks and encouraged the continuation of hoarding which had been practiced so widely before the bank holiday.

The lessened purchasing power of the community due to the bank closings and limitations upon withdrawals, as well as the continued hoarding by the people, made the banking situation show definite signs of weakening. The evidences of this weakening were:[152] (1) Banks needing new capital as a condition of reopening were hard pressed to get the amount needed. (2) Banks which had reopened had found themselves heavily drawn upon by

[151] Ibid., Page 24
[152] Ibid., Page 27

depositors because of the need of money to pay expenses, and because there was little confidence in many of the banks still open. (3) This need for cash caused the country banks to draw upon city correspondents steadily and heavily. (4) Banks under the direction of creditors or conservators were pressed to make immediate cash payments of a part of depositors' claims, and this caused them to try to sell securities in the exchanges. Whenever such sales were successful, the banks received settlement by checks drawn upon city banks which meant that these latter institutions were being obliged to help to a considerable extent in the liquidation of the claims of depositors in the country banks. This action weakened the metropolitan banks.

Furthermore, the lull in business which had followed the banking holiday had not disappeared completely and funds normally expended by communities came back to banks very slowly.

It was apparent to those in authority that some other action had to be taken to restore the public's confidence in the banks if they were to continue normal operations. The "Glass Bill" passed in February 1933 had proposed a liquidating corporation to take over and pay off (in bank credit) the deposit claims in closed institutions. This would have involved the transfer of deposit payments of closed banks to those which had remained open, thus giving the depositor in the closed bank the amount of his deposit less an amount in proportion to the depreciation of the assets of the bank which had failed. The failure to do this was an implied admission of the limitation of the

buying power of the community. It was like building a dam and then forgetting to shut the gates.

It was clear by this time that the temporary relief measures were not adequate and that additional steps of a more rigorous nature had to be taken. The underlying difficulties were not to be remedied by surface treatment.

There were several weaknesses of the banking structure of the country that had to be eliminated or improved such as the reserve requirements against time and demand deposits, speculation in bank stocks, affiliates, qualifications and numbers of directors for national banks and holding companies of bank stocks, branch banking, etc., but it is not the purpose of this thesis to outline the remedies proposed or comment upon their sagacity.

Chapter Four

THE EMERGENCE OF DEPOSIT GUARANTY LEGISLATION

In the early part of the first session of the seventy-third Congress there appeared a large brood of bills providing for the guaranty of bank deposits. This proposal had a big headway in the House of Representatives and could not be ignored.[153] It became evident to Mr. Glass, Chairman of the Senate Banking and Currency Committee, that one of these deposit guaranty bills was sure to pass both houses. Therefore, Mr. Glass proceeded to incorporate the guaranty of deposits idea in his banking bill in order that the latter might be more certain of passage. He seized this opportunity also to incorporate in the Banking Act of 1933 certain measures that might be difficult to get by except through a compromise with the proponents of deposit guaranty. The original liquidating corporation idea now appeared as a "deposit insurance corporation", so-called. The purpose of this corporation was to be the liquidation of insolvent banks and, at the same time, to insure depositors against loss by assessing solvent banks a certain percentage of their deposits to provide money to pay the depositors in closed banks.

When the deposit guaranty idea began to take shape in the House there were two variations of it: The first plan called for the Treasury to assume the total cost of guaranteeing bank deposits, while the second provided for a levy of solvent banks to pay depositors in failed banks. The final plan was a compromise under which the Government was to provide one hundred

153 Ibid., Page 99

and fifty million dollars capital for the new corporation which sum was estimated to be equivalent to the amount of money collected from the reserve banks as an excess earnings franchise tax. The Glass Bill, therefore, included a bank deposit guaranty plan which was not so extreme as some of the plans that had been proposed but which, nevertheless, was included much to the regret of Mr. Glass.

The Administration was opposed to the Bill when it was finally completed and reported. In addition to the President's opposition, there was the opposition of the New York bankers who had expressed themselves in a joint letter as unanimously opposed to bank deposit guaranty and generally to the whole Bill. It was about decided to let the banking legislation await a more opportune time, but an investigation of the relationship between the investment bankers and the banks (investment affiliates) by another Senate Committee and which was touched upon by the Glass Bill in a small way caused a general demand for the passage of the Bill.[154] The impetus of the investment-banking inquiry made the Glass Bill law in the closing hours of the session. On June 16, 1933, Mr. Roosevelt signed the measure and announced that the legislation was the best of its kind since the Federal Reserve Act.

It is unfortunate that such an important measure as a bill dealing with banking legislation should be carried through Congress on a wave of emotion, but such has been the procedure in enacting banking legislation in the United States for more than

[154] Ibid., Pages 100-102

a century. Such methods are not conducive to prompt, constructive, effective, and adequate laws.[155]

[155] Ibid.

Chapter Five

THE FEDERAL DEPOSIT INSURANCE CORPORATION

The Corporation

"The Banking Act of 1933" provides for the creation of a corporation to be known as "The Federal Deposit Insurance Corporation". The purpose of the corporation is to carry out the provisions of the Act which pertain to the Insuring of bank deposits, and its principal functions are to purchase, hold, and liquidate the assets of national banks and state banks which are members of the Federal Reserve System which may be closed, and to insure the deposits according to the provisions of the Act.[156]

Management

The management of the Federal Deposit Insurance Corporation is vested in a board of three directors consisting of the Comptroller of the Currency and two other persons appointed by the President of the United States. These directors must be appointed for a period of six years, and the two members of the board other than the Comptroller receive $10,000 a year for their services. The Comptroller is not given any additional compensation because of his duties on the board.[157]

Powers and Duties of the Corporation

The corporation has those powers customarily delegated to corporations such as the power to make contracts, sue and be sued, hire employees, establish by-laws, etc. In addition, it is empowered to make whatever rules, regulations, and contracts it deems necessary to carry out the provisions of the deposit

156 "Bank Deposit Insurance", Edited by John Edson Brady, The Banking Law Journal, Cambridge, Massachusetts (1933) -- Page 35

157 Ibid.

insurance law.[158]

The corporation is entitled to the free use of the mails, and may make use of the information, services, and facilities of any board, commission, or department of the United States with the consent of such board, department, or commission.[159]

The corporation is required to render an annual report to Congress as soon as practicable after the first of January of each year. It is required to invest the money of the corporation when not employed in another manner in the securities of the United States. (The board may deposit funds on a temporary basis with any Federal Reserve Bank or with the Treasurer of the United States.)

Capital

The stock of the Federal Deposit Insurance Corporation consists of three classes, all shares of which have a par value of $100. The first class consists of the stock issued to the United States for the capital supplied the corporation; the second class of stock issued to the banks becoming members of the Corporation, known as Class A stock; and Class B stock which is issued to the Federal Reserve Banks.[160]

The law provides that the shares of stock held by the Corporation and by member banks may not be transferred or hypothecated.

The Act provides that the United States Treasury shall provide capital for the corporation to the extent of $150,000,000, and for which it must be given capital stock of the corporation

158 Ibid., Page 36
159 Ibid.
160 "The Outline of the 'New Deal' Legislation of 1933", Howard S. Piquet, McGraw-Hill -- Page 39

in an equal amount.

The Class A stock is issued to those banks which are members of the Federal Reserve System (compulsory participants) and non-member banks of the Federal Reserve System which may elect to share in the benefits of the F.D.I.C.[161] Upon making application for the privilege of participating in the insurance plan of the corporation, each bank must subscribe for Class A stock to the extent of one-half of one per cent of its deposit liabilities.

The Class B stock is issued to the Federal Reserve Banks in exchange for subscriptions amounting to one-half of the surplus of these banks as of January 1, 1933.

It was estimated that the capital of the corporation would be in the vicinity of $490,000,000, $150,000,000 being derived from the Treasury, $140,000,000 (estimated) from the Federal Reserve Banks, and approximately $200,000,000 from the banks electing to become participants in the insurance program.

The Act provides further that those banks which are prohibited by state laws from purchasing the stock of the corporation can fulfill the requirements of the Corporation for membership by depositing with the corporation an amount equal to the amount which it would have been required to pay in for stock upon joining the corporation; and the banks taking such a course are considered as Class A stockholders. It is provided that interest must be paid on these deposits at the same rate as the dividends paid on Class A stock outstanding. Such banks have to

161 "Bank Deposit Insurance", Edited by John Edson Brady, The Banking Law Journal, Cambridge, Massachusetts (1933) -- Pages 37-38

subscribe for the stock within six months if the states in which they are located grant the power subsequent to making the deposit.

It is provided that only banks organized at the time of the enactment of the legislation creating the Federal Deposit Insurance Corporation may take advantage of the foregoing provisions. Banks organized after June 16, 1933, applying for stock must purchase Class A stock to the extent of five per cent[162] of the new bank's capital, provided the application to buy the stock is made within twelve months after organization. After the twelve month period, the amount of stock subscribed for by such a bank must be adjusted annually in the same manner as that of other member banks.

Other Provisions Regarding Capital Subscriptions[163]

After July 1, 1934, a state bank wishing to become a Federal Reserve Member bank will be admitted only after it has subscribed for the amount of Class A stock required of all participants in the deposit insurance program of the United States. It is provided also that a national bank which fails to become a stockholder of the Deposit Insurance Corporation on or before July 1, 1934, must be taken over by the Comptroller of the Currency as receiver or conservator for the bank. Furthermore, any state bank which is a member of the Federal Reserve system and which fails to become a member of the Federal Deposit Insurance Corporation on or before July 1, 1934, cannot continue its membership in the Federal Reserve System.

The capital subscriptions of the Federal Deposit Insurance

[162] Ibid., Page 38
[163] Ibid., Page 40

Corporation are payable to the Corporation in the following manner: The $150,000,000 subscribed by the United States is subject to call by the Board of Directors of the Corporation at any time. The subscription of the Federal Reserve banks (one-half surplus) was payable to the extent of one-half of the subscription at the time of subscription, and the balance subject to call by the Board of Directors of the Corporation upon ninety days notice.

One-half of the amount subscribed by the banks becoming shareholders of the Corporation is payable at the time the subscription of the bank is accepted by the Corporation, and the remainder is made subject to call from time to time by the Board of Directors of the Corporation.

Adjustment of Stock to Deposit Liabilities

The Act provides that banks becoming shareholders of the Class A stock of the Deposit Insurance Corporation must adjust their holdings of this stock so that it will be equal in amount to one-half of one per cent of the bank's deposit liabilities. This adjustment must be made at the beginning of the calendar year, and the adjustment made for both increases and decreases. (When deposits fall off during a year, the bank must surrender a proportionate amount of its stock.) The payment for the additional stock required because of an increase in deposits may be paid for on the same basis as the original subscription made for the stock of the Corporation.[164]

It is provided in the Act that when a bank liquidates, it must surrender its stock in the Corporation. The bank liquidating

[164] Ibid., Page 41

is entitled to receive its cash paid subscriptions plus dividends not exceeding one per cent per annum from the time of the last dividend less any liability to the Corporation.

Certification for Membership[165]

When a bank applies for membership in the Corporation, the Corporation is required to request the Federal Reserve Board in the case of a state Federal Reserve member bank, or the Comptroller in the case of a national bank, to certify upon examination that the applying bank has assets adequate to meet its deposit liabilities as shown by its books. When the certification is negative, the application for stock must be denied.

Dividends on Stock of F.D.I.C.

The dividends upon the Class A stock held by member and non-member banks of the Federal Reserve System are fixed at six per cent per annum or thirty per cent of the net earnings in any one year, whichever amount is greater. These dividends are cumulative.[166] The participation in the declaration or payment of a dividend by an officer or director of a bank holding Class A stock in the Corporation while any assessment levied against the bank by the Corporation remains unpaid, is subject to a fine of $1000 or imprisonment for a year or both.

THE TEMPORARY INSURANCE PROVISIONS

The Temporary Fund

The Act of June 16, 1933, provided that the Corporation should open on its books a Temporary Federal Deposit Insurance Fund to become operative on January 1, 1934, to insure to the

165 Ibid., Page 42
166 Ibid.

extent of $2500[167] each deposit in any bank which is a member of the Fund, and which closes on or before June 30, 1934. (This Temporary Fund could be made operative earlier by Presidential proclamation.)

The amount of insurance of deposits for each depositor was increased to $5,000 by amendment to the original Act to be effective July 1, 1934, for purposes of the October 1, 1934, statement of Fund members which had to be submitted.[168]

Member Banks of the Temporary Insurance Fund

The following banks were compelled to join the Fund:[169] All banks that are members of the Federal Reserve system licensed by the Secretary of the Treasury by the first of January 1934; all banks which are members of the Federal Reserve System and which are licensed after January 1st, 1934; all state banks, trust companies, and mutual savings banks (see Page 178) and each banking institution located in the District of Columbia which becomes a member bank of the Federal Reserve System on or after January 1st, 1934, must become a member of the Fund when admitted to the system.

The following banks were privileged to join the Fund: Any state bank, trust company, or mutual savings bank (see Page 175) and any banking institution in the District of Columbia which is not a Federal Reserve System member bank, provided the authority having supervision of the bank grants approval, and provided further that this supervisor or authority tenders a certificate that the bank is in solvent condition and is found to be so by

167 Ibid., Pages 42-43
168 Amendment to Section 12-B of the Federal Reserve Act of 1933
169 "Bank Deposit Insurance", Edited by John Edson Brady, The Banking Law Journal, Cambridge, Massachusetts (1933) -- Pages 42-43

the Corporation. The bank must agree to comply with the regulations of the Corporation and must pay to it the amount required of Class A members of the Fund. (The Corporation is empowered to examine the banks which apply for membership and which are not members of the Federal Reserve System, the expense of which may be assessed against the bank becoming a member.)

Statements Required of Members in the Temporary Fund

Prior to admission to the Temporary Insurance Fund, each bank becoming a member of the fund must file with the Corporation a sworn statement showing the number of depositors and total deposit liabilities eligible for insurance as of the fifteenth of the month preceding the month of admission of the bank as a deposit guaranty bank.[170]

The Act of June 16, 1933, stated that each bank must file a statement similar to that required for admission as of June 15, 1934, and upon such other dates as fixed by the Corporation.

Payments and Assessments

When a bank is admitted to the Federal Deposit Insurance Corporation's Temporary Insurance Fund it is obligated to pay immediately an amount to the Temporary Fund equal to one-half of one per cent of its deposits eligible for insurance. One-half of this amount must be paid upon admission and the remainder held subject to call at any time by the Corporation. When the June 15, 1934, statement rendered to the Corporation indicates an increase in deposits, the bank whose deposits are insured must pay an amount equal to one-half of one per cent of this increase.

[170] Ibid., Pages 43-44

The Act provides also that when the Corporation has need of additional funds to meet the obligations of the Temporary Fund prior to July 1, 1934, each member bank of the Fund is subject to an assessment of a sum equal to the sum paid prior to this time.

Amount of Insurance

Under the original Act the member banks of the Temporary Insurance Fund are provided insurance for the deposits in each bank to the amount of $2500.[171] This provision applies only to the deposits which have been subject to withdrawal in the usual course of the banking business since March 10, 1933. This provision on the amount of insurance was amended to insure deposits to the amount of $5,000 for each depositor in fund member banks as per a statement of deposits and condition to be submitted to the Corporation showing condition as of October 1, 1934.[172]

Procedure When Member of Fund Closes

The law provides that the procedure to be followed when a member bank of the Temporary Fund closes must conform to the provisions in the Act pertaining to the action to be taken by the Corporation when a national bank closes. The provisions pertaining to the closing of a national bank are as follows:[173] When a national bank which is a Class A stockholder of the Corporation is forced to close its doors because of inability to meet the demands of depositors, the Comptroller of Currency must appoint a receiver for the bank. Following the appointment of the receiver, a new national bank must be organized by the

171 Ibid., Page 44
172 Amendment to Section 12-B of the Federal Reserve Act of 1933
173 "Bank Deposit Insurance", Edited by John Edson Brady, The Banking Law Journal, Cambridge, Massachusetts (1933) -- Page 45

Comptroller to take over the insured deposits of the closed national bank and to receive new deposits.

The Corporation must make available to the new bank an amount equal to the insured deposit liabilities of the closed bank, and the new bank must assume all of the deposit liabilities of the closed bank. At the same time, the Corporation is required to take over the depositors' rights in the closed institution.

When the receiver declares dividends to depositors in the closed bank as a result of liquidating the closed bank's investments, such dividends must be paid to the Corporation until the amount received by the latter equals the amount of the insured deposit liability of each depositor. When this happens, subsequent dividends may be paid directly to the depositor.

The Corporation is instructed by law to liquidate the assets of the closed banks, enforce the individual liability of each stockholder and director, and to wind up the affairs of the institution in accordance with the laws of the United States pertaining to the liquidation of national banks.

The New Bank[174]

The provisions pertaining to the new bank that must be created as part of the procedure for protecting depositors in closed banks deserve mention.

The Act provides that the organization of the new bank must be directed by the Corporation. The articles of association of the new bank may be executed by any persons designated by the

[174] Ibid.

Corporation and following the execution of the articles of association, the Corporation may offer the stock of the new bank for sale. The amount of the capital stock of the new bank must be at least the minimum amount required for the organization of a national bank in the place where the bank is located.

When the capital stock of the new bank has been subscribed and paid for, the Comptroller of the Currency may issue a permit to begin business. Prior to this time, however, the affairs of the new bank must be administered by an executive officer designated by the Corporation.

When the bank begins business under its own management it must elect a Board of Directors to take over the management of the bank.

Unless the capital stock of the bank is sold within two years, or unless some bank takes over its assets and assumes its liabilities within two years after its organization, the Corporation is compelled to place the bank in voluntary liquidation.

It has been stated that the Corporation is required to pay to the new bank an amount equal to the insured deposit liabilities of the closed bank. The actual payment consists of only enough money to enable the new bank to meet demands for cash, and the balance is credited to the account of the new bank on the books of the Corporation. This credit to the account of the new bank bears interest at three per cent per annum until withdrawn by the new bank.

The acceptance of deposits by the new bank must be done in accordance with the regulations imposed by the Corporation also. These deposits, as well as the funds made available by the Corporation, must be kept in cash on hand, invested in direct obligations of the United States Government, or deposits with the Corporation or a Federal Reserve Bank.

The new bank is required to keep on deposit with the Federal Reserve bank of its district an amount equivalent to the legal reserve requirements of the system, but this new bank may not be required to subscribe to the stock of the Federal Reserve bank in its district until its own stock has been subscribed and paid for in full.

Procedure When State Member Bank Closes

When a state member bank closes its doors because it is unable to meet the demand of its depositors, the Corporation may be appointed receiver by the proper state authorities. The Corporation then proceeds to make available to the new bank an amount equal to the insured deposit liabilities of the closed state bank, provided the Corporation is satisfied that it is entitled to receive dividends resulting from the liquidation of the assets of the closed state bank.[175]

The procedure followed is exactly the same as in the case of the national bank except that the rights of the creditors of the bank must be determined in accordance with the laws of the state where the bank is located. (The procedure is dependent upon the action not being in violation of the state laws where

[175] Ibid., Page 47

the bank is located.)[176]

Where the Corporation has no right to act as receiver of a closed bank which is a Class A stockholder in the Corporation, the Corporation must proceed to organize a new national bank to take over the deposit liabilities as in the case of the closed national bank. The affairs of the closed bank, however, are wound up by a receiver appointed by the proper state officials. The Corporation is authorized to purchase and liquidate any or all of the assets of the closed state bank.

Deposit Insurance Account[177]

The Corporation is required to open on its books a deposit insurance account.

When a bank fails, the Corporation must estimate the amount that it may expect to realize from the liquidation of the assets of the closed bank to apply against the claims of the depositors in the institution. If the amount that the Corporation has made available to the new bank exceeds the amount of the estimate, the excess must be debited to the deposit insurance account.

When the amount realized upon the assets of the closed bank is less than estimated, the amount of the deficiency must be charged to the deposit insurance account. If the amount so realized exceeds the estimate, the deposit insurance account must be credited with the excess.

Assessments Against Class A Stockholders

The Act provides the following in regard to the assessment of member banks.[178] When the net debit balance of the deposit

[176] Ibid., Page 47
[177] Ibid., Pages 47-48
[178] Ibid., Page 48

insurance account equals or exceeds one-fourth of one per cent of the total deposit liabilities of all Class A stockholders in the Corporation as of the date of the last preceding Call Report, the Corporation is required to levy upon each Class A stockholder an assessment equal to one-fourth of one per cent of its total deposit liabilities. The amount so collected is credited to the deposit insurance account. The assessment contains no limitation upon the number of assessments which may be levied.

Deposits Payable at a Foreign Office[179]

The deposits of a bank insured under the Temporary Insurance Fund do not include deposits payable at a foreign bank or office of a bank located in a foreign country. Such deposits, therefore, are excluded in determining the deposit liability of a bank.

The Permanent Insurance Plan[180]

The Act of June 16, 1933, provides that the deposits in all member banks of the Federal Reserve System will be insured on and after July 1, 1934, unless the President fixes an earlier date by proclamation. All these banks were to be examined in the meantime. The deposits of all non-member banks which are Class A stockholders of the Corporation will be insured on and after July 1, 1934, unless an earlier date is fixed by the President by proclamation. In the meantime, all such banks will be examined. The insurance will continue until July 1, 1936, when the bank must become a member of the Federal Reserve System or relinquish its insurance benefits.

179 Ibid., Page 48
180 Ibid., Page 45

Amount of Permanent Insurance[181]

Under the Permanent insurance plan, deposits up to $10,000 will be fully insured. Deposits in excess of $10,000 but not exceeding $50,000 will be insured to the extent of seventy-five per cent, and all deposits in excess of $50,000 will be insured to the extent of fifty per cent. It is provided further that in determining the amount due any depositor there must be included all deposits due him in his own name or held in the name of another for his benefit.

Power to Issue Securities[182]

The Federal Deposit Insurance Corporation is empowered to issue and have outstanding at any one time securities the aggregate amount of which do not exceed three times the Corporation's capital.

The maturity and rate of interest of such securities is left to the discretion of the Corporation. The securities may also be redeemed before maturity at the option of the Corporation in such manner as may be stipulated in its obligations. The securities of the Corporation may be secured by the Corporation's assets and the prices fixed by the Corporation. The Corporation is empowered also to sell on a discount basis short-term obligations payable at maturity without interest.

Fund for Mutuals[183]

The original banking act has been amended to provide for an additional Temporary Federal Deposit Insurance Fund to be known as "The Fund for Mutuals". The purpose of this fund is to

---

181 Ibid., Page 45
182 Ibid., Page 48
183 Amendment to Section 12-B of the Federal Reserve Act

provide separate protection for mutual savings banks wishing to protect depositors under the Federal Deposit Insurance Law. It is provided that the fund shall terminate on July 1, 1937.

A mutual savings bank may elect to become a member of the Temporary Insurance Fund or a member of the Fund for Mutuals. If the bank elects to become a Temporary Fund member it is expected to meet the requirements for membership in the fund and bear all assessments that may be imposed upon all other banks joining the Temporary Fund.

When a mutual savings bank elects to become a member of the Fund for Mutuals, the law provides that its deposits shall be insured to the extent of $5,000 for each deposit account in the bank provided the bank closes on or After July 1, 1934. However, mutual banks electing to become Temporary Fund Members are entitled to insurance for each deposit account up to the amount of $2500 unless the board of directors of the fund elects to grant coverage to the extent of $5000 for each depositor in the particular bank.

Mutual savings banks that have been members of the Temporary Fund and wishing to transfer their membership to the Fund for Mutuals may do so, and the Corporation is instructed to pay all assessments levied for the Temporary Fund less any debts of the transferring bank to the Temporary Fund to the Fund for Mutuals. The Temporary Fund and Fund for Mutuals have no liability on account of or to each other except in case of a member transferring membership.

Eb.

It is provided that the payment of depositors in closed mutual savings banks that are members of the Fund for Mutuals shall be as in the case of closed member banks of the Temporary Fund. The same rules of liquidation and assessments shall apply also.

The law provides that a state bank in order to obtain the benefits of the Fund for Mutuals after July 1, 1935, must subscribe any pay for the same amount of Class A stock of the Corporation as it would be required to subscribe and pay for upon becoming a member of the Federal Reserve System. In cases where the state laws do not allow the bank to make such subscriptions, the bank must make a deposit with the Corporation equivalent to the subscription.

Federal Deposit Insurance Corporation in Operation

Deposits Insured

A preliminary summary of the certified statements of Federal Deposit Insurance Corporation shareholders and participants as of October 1, 1934, was published on January 17, 1935.[184]

This summary showed that there were 14,125 banks actively participating in the insurance funds of the Corporation. Through these banks insurance was being provided to 51,245 depositors, of which 50,422,497 were being given full protection. The ratio of fully insured depositors to the total number of depositors was 98.39%. This becomes a very significant figure when it is learned that out of the total deposits in these banks of $37,019,742,000, only $16,452,433,000 or 44.44% is insured.

[184] Preliminary Summary of Certified Statements, F.D.I.C., Issued by Statistical Division January 12, 1935 -- Released January 17, 1935

(See Table on Page 179)

The banks participating in the insurance benefits of the Corporation on October 1, 1934, were classified as follows:[185]

National Banks	5,450
State Banks (Members of Federal Reserve System)	969
State Banks Not Members of Federal Reserve System, Exclusive of Mutual Savings Banks	7,638
Mutual Savings Banks (Maximum Insurance $5000)	44
Mutual Savings Banks (Maximum Insurance $2500)	24
Grand Total All Banks	14,125

The statement that only 44.44% of the total deposits in these banks is covered by insurance and that over 98% of the depositors is being given protection is very significant. The figure shows that the bulk of deposits in banks is small, that in over 98% of the cases the average deposits are below $2500. Furthermore, the desired confidence in the banking system, on the part of the majority of depositors, is achieved by assuming a risk of much less proportion than would be the case if all deposits were insured one hundred per cent. (It will be remembered that in the case of the state guaranty plans deposit insurance afforded one hundred per cent coverage to all depositors, regardless of the size of the deposit involved.)

There were originally one hundred and sixty-one additional mutual savings banks in the Corporation. One hundred and thirty-three of these withdrew on June 30, 1934, because of the creation of a state-wide insurance fund in the State of New York where these banks were located. These banks made application to with-

[185] Ibid.

FEDERAL DEPOSIT INSURANCE CORPORATION
PRELIMINAY SUMMARY OF CERTIFIED STATEMENTS, AS OF OCTOBER 1, 1934
(DEPOSITS IN THOUSANDS OF DOLLARS)

CLASS OF BANK	NUMBER OF BANKS	INSURED DEPOSITS	UNINSURED DEPOSITS	TOTAL DEPOSITS	RATIO OF INSURED TO TOTAL DEPOSITS - %	DEPOSITORS FULLY INSURED	DEPOSITORS PARTLY INSURED	TOTAL NUMBER OF DEPOSITORS	RATIO OF FULLY INSURED TO TOTAL DEPOSITORS - %
NATIONAL BANKS	5,450	8,488,554	11,583,949	20,072,503	42.29	25,972,035	405,811	26,377,846	98.46
STATE BANKS MEMBERS FEDERAL RESERVE - (EXCLUSIVE OF MUTUAL SAVINGS BANKS)	969	3,582,449	7,382,986	10,965,435	32.67	9,361,278	199,082	9,560,360	97.92
STATE BANKS NOT MEMBERS FEDERAL RESERVE - (EXCLUSIVE OF MUTUAL SAVINGS BANK)	7,638	3,580,803	1,363,262	4,944,065	72.43	13,687,403	124,947	13,812,350	99.10
ALL BANKS - (EXCLUSIVE OF MUTUAL SAVINGS BANKS)	14,057	15,651,806	20,330,197	35,982,003	43.50	49,020,716	729,840	49,750,556	98.53
MUTUAL SAVINGS BANKS - MAXIMUM INSUARANCE $5,000	44	412,727	54,117	466,844	88.41	888,451	19,421	907,872	97.86
MUTUAL SAVINGS BANKS - MAXIMUM INSURANCE $ 2500	24	387,900 387,800	182,095	570,895	67.95	513,330	73,484	586,814	87.48
ALL MUTUAL SAVINGS BANKS	68	800,627	237,112	1,037,739	77.15	1,401,781	92 905	1,494,686	93.78
GRAND TOTAL - ALL BANKS	14,125	16,452,433	20,567,309	37,019,742	44.44	50,422,497	822,745	51,245,242	98.39

NOTES

1. TOTAL DEPOSITS AS REPORTED TO THE CORPORATION ON OCTOBER 1ST DIFFER IN SOME RESPECTS FROM GROSS DEPOSITS SHOWN ON BANKS PUBLISHED STATEMENTS.
2. FOUR BANKS NOT REPORTING STATISTICS.
3. THIRTY-EIGHT BANKS DID NOT REPORT DUE TO VOLUNTARY LIQUIDATION OR MERGERS AND CONSOLIDATIONS.

draw prior to the passage of the amendment to the Act providing for a separate fund for mutual savings banks.

The Fund

A report of the Corporation summarizing operations as of June 30, 1934, stated that the Corporation had on deposit with the Treasury $99,247,340.84, and investments in Government bonds amounting to $227,782,343.36 on which there was an appreciation of $7,478,101.23 as of June 30, 1934.[186]

The interest earned on investments for the period was $2,338,788.62, while the expenses of the organization (including organization, the failure of one bank closed during the period, and a provision of $400,000 for estimated suspense items) amounted to $3,207,365.15[187]

At the close of business on June 30, 1934, the assessments collected from banks which were members of the fund amounted to $39,664,640.58. The cost of insurance was 5.8054 cents per $1000 insured deposits, equal to 2.32% of the assessment paid by banks which are members of the Temporary Fund.

Withdrawals

The Corporation was prepared at the time of publishing its report to meet refunds of $9,273,783.00 of 188 banks which were making withdrawals in accordance with the provisions of the regulations of the Corporation. The withdrawal of the New York mutual savings banks has been mentioned already. Twenty-one of the banks withdrawing were commercial banks.[188]

---

[186] Preliminary Report of the Chairman of the Board of Directors of the F.D.I.C. on Operations to June 30, 1934 -- Page 2

[187] Ibid., Page 1

[188] Ibid., Page 2

Failures of Insured Banks

Since the Federal Deposit Insurance Corporation has been in operation there have been six bank failures among the insured banks. The total deposit liabilities of these banks at the time of closing amounted to $1,512,000, and the total of insured deposits was $673,837. This insurance insured in full more than ninety-nine per cent of the depositors. There were in the aggregate 13,123 depositors.[189]

Assessments

Thus far in the operation of the Federal Deposit Insurance Corporation there have been no additional assessments to pay depositors. A letter to the writer from G. B. Wharton of the Corporation dated February 14, 1935, states: "Failures of insured banks have not been the occasion for any additional assessments of insured banks, this being the answer to your question on that topic."

189 Address of the Honorable Leo T. Crowley, Chairman of the Board of the F.D.I.C., Before the American Bankers' Association Convention -- Page 8

PART V

PART V

THE CASE FOR AND AGAINST THE FEDERAL DEPOSIT INSURANCE LAW

Chapter One

Introduction

The significance of the creation of the Federal Deposit Insurance Corporation is well stated in this quotation from the American Bankers' Association Journal for October 1933: "The inauguration of a system of deposit insurance by the Banking Act of 1933 of itself forms a land mark in American Banking History, but it is probable that in the long run the provisions as to Reserve membership and the control of banks incidental to the operation of the plan will prove far more important. These changes in the banking law are the most important made since the passage of the National Banking Act of 1863. The old system has operated for seventy years. It is hardly possible that the new phase in American banking history, ushered in by the Banking Act of 1933, will endure so long."[190]

The following pages will present the case for and against the Federal Deposit Insurance Law. The writer will attempt to show what might have happened had the law been in existence from 1920 until the National Bank Holiday; and, in addition, to point out several defects of the law. In contrast, the case for Deposit Guaranty on a national scale, as well as some of the possible developments under the law, will be presented.

190 "The Price of Deposit Insurance", F. M. Law, American Bankers' Association Journal, February 1933 -- Page 17

Chapter Two

THE CASE AGAINST THE FEDERAL LAW

A Study of What Would Have Happened to Bank Deposit Guaranty During the Years 1920-1932

Those who oppose the Federal bank deposit guaranty program base their conclusions largely on the grounds of the previous experience and results attained by bank deposit guaranty systems. It is pointed out that guaranty laws encourage unsound banking, and that the expenses of paying depositors is borne in the largest part by the soundly managed institutions. It is also pointed out that the guaranty programs do not insure the multitude of individual deposits. In order to protect the depositors in a few weak banks, the security of deposits in the remaining banks is jeopardized. In substantiation of this assertion, one is asked to examine the results that would have been attained by a deposit guaranty program in effect as of the year 1920.[191]

If a bank deposit guaranty program had been in effect in 1920, applicable only to the member banks of the Federal Reserve System, and if each member bank had paid an amount equal to ten per cent of its paid-in capital to a guaranty fund, the results would have been quite far from satisfactory. The answer is to be found by an examination of the table on Page 184. This table shows the amount of suspended banks together with the amount that would have been in the fund from 1921-1929 (the years following 1929 are excluded because of heavy failures.).[192]

The table shows that if the fund had been increased each year by ten per cent of the reported increase in capital of member banks, it would have been sufficient to pay all depositors

191 "Futility of Deposit Guaranty Laws", Frederick A. Bradford, Bankers' Magazine, Volume 126 -- Page 537

192 Ibid.

TABLE 1[193]

Date	Amount in Assumed Fund	Deposits of Suspended Banks	Contributions of Suspended Banks to Fund
January 1921	$179,906,100	$42,503,000	$ 536,900
1922	144,279,100	24,243,000	395,600
1923	127,345,600	51,228,000	684,500
1924	82,341,400	74,469,000	1,030,500
1925	11,315,100	67,264,000	992,000
1926	6,782,700	68,812,000	856,900
1927	9,813,900	66,336,000	803,400
1928	13,433,300	42,240,000	517,500
1929	13,644,300	57,135,000	712,500

Deficiency, End of 1929 -- $236,797,700

TABLE 2[194]

January 1930	275,711,300	380,440,000	5,041,000
1931	----------	733,528,000	8,386,000
1932	----------	270,782,000	---------

193 Ibid., Page 538
194 Ibid.

of failed banks through 1924. Thereafter, the contributions to the fund representing ten per cent of the increase in capital of member banks would have served to pay but a small portion of the deposits of member banks.

By the end of 1929 the deficiency would have amounted to $236,797,700, or an additional 8.6% of the paid-in capital of member banks at that date. The fund would have been reimbursed by the liquidated assets of failed banks, but it is highly improbable that these would have been enough to pull the fund out of the red by the end of 1929.[195]

Non-member bank failures were more than member bank failures, and if these banks had been included in the insurance program, the fund would have been in the red in 1922. If non-member banks had been included the deficiency at the close of 1929 would have amounted to $1,300,000,000.[196]

These results are insignificant when compared to what would have happened from 1929 to 1932. Assuming a fund had been started in December 1929 paying depositors in 1930, the fund would have been depleted before the end of that year. (See Table on Page 184)

By the end of 1932 the deficiency in the guaranty fund would have been more than $1,000,000,000, or about 40% of the paid-in capital of existing member banks. Had all the banks in the United States been included instead of just member banks only, the deficiency would have been close to $2,000,000,000.[197]

The foregoing statistics indicate without question that a

[195] Ibid., Page 537
[196] Ibid.
[197] Ibid.

national deposit guaranty system such as the one suggested would have been futile. It can be seen readily that such an impairment of capital of member banks would have forced many honestly managed and otherwise solvent banks into insolvency. Surely this system cannot be said to be in the interest of the deposits when considered in the aggregate.

A more detailed analysis of what might have been the cost of a deposit guaranty system to participating banks has been compiled by the Commission on Banking Law and Practice of the Association of Reserve City Bankers. The cost to participating banks is shown in the table on Page 187 for the period from 1921 to 1932. This table is for all banks, state and national.[198] The Committee believes these tables are significant in that the federal law imposes an unlimited contingent liability on all participating banks. This table shows that the ratio of losses to deposits of active banks would have risen from 0.15% in 1921 to 1.10% in 1931. The ratio of losses to capital for these same years would have been 0.85% and 3.05%.[199] It is extremely doubtful if a great many banks could have withstood the losses shown for the latter years. Not only was the year one of adversity in business, but it was also a time when the public confidence in banks was at a low ebb. The sure test of a guaranty system comes during such years. "It must weather the storms of panic and depression if it is to prove its worth." Such depressions and panics have occurred many times in the history of our country and there is no reason to believe that there will be no more.

198 "The Guaranty of Bank Deposits" (Bulletin No. 3), Commission on Banking Law and Practice, Association of Reserve City Bankers, November 1933 -- Page 13

199 Ibid., Pages 14-15

Estimated Losses to Depositors of State and National Banks Which Suspended During 1921-1932*

Exclusive of Mutual Savings and Private Banks - Amounts in Millions of Dollars

YEAR	Deposits of Active Banks June 30	Capital Funds of Active Banks June 30	Deposits of Banks Suspending	Estimated Loss to Depositors of Failed Banks (1)	Estimated Loss Which Would Have Been Borne by the Guaranty Fund (2)	Ratio of Losses to Deposits of Active Banks (%)	Ratio of Losses to Capital Funds of Active Banks (%)
1921	$32,948	$5,884	$163	$56	$50	0.15	0.85
1922	35,193	5,987	89	31	27	0.08	0.46
1923	37,818	6,177	146	50	45	0.12	0.73
1924	40,884	6,373	202	69	62	0.15	0.98
1925	44,704	6,580	160	55	49	0.11	0.75
1926	46,346	6,954	250	86	77	0.17	1.11
1927	48,534	7,331	195	67	60	0.12	0.82
1928	49,645	7,879	139	48	43	0.09	0.54
1929	48,796	8,513	223	76	69	0.14	0.81
1930	50,550	8,943	822	281	253	0.50	2.83
1931	46,770	8,326	1669	571	514	1.10	6.17
1932	35,311	7,039	698	239	215	0.61	3.05
Total	$517,499	$85,986	$4,756	$1,629	$1,464		
Annual Average for 12 Years	$43,125	$7,165	$397	$136	$122	0.28%	1.70%

(1) Estimated on the basis of experience of 11% of the deposits of reopened banks and 40% of the deposits of banks placed in liquidation.

(2) Estimated at 90% of the total loss to depositors because of the predominance of small institutions among failed banks.

NOTE - The losses in the failed banks during recent years do not tell the whole story because many insolvent banks were kept open temporarily until the crisis of 1933.

* The Guaranty of Bank Deposits - Bulletin No. 3 - Commission on Banking Laws and Practice - Association of Reserve City Bankers.

It is only when the country is in a period of depression and the public confidence in banking is badly shaken that there is a demand for deposit guaranty. It appears from these statistics that the system is doomed to failure when it is most needed.[200]

A more detailed analysis of the costs that would have been borne by a guaranty fund had it been in effect during the period 1930-1932 is shown on Page 176A. This table indicates that the losses borne by the guaranty fund would have averaged annually three-fourths of one per cent of all deposits, and 4.04 per cent of capital funds of active banks.[201] It is pointed out by the Committee on Banking Law and Practice that these losses are understated because banks failing during a depression pay smaller dividends to depositors than those failing in years of less stringent business activity on the basis of which these statistics were compiled. Furthermore, many of the banks closing in recent years reopened by scaling down deposits, and the losses to depositors would average higher than the statistical experiences if reopenings in prior years would indicate. (During 1933 deposits were scaled down to the extent of sixty-five per cent in some instances.)[202] In addition, as it is stated on the chart on Page 189 many insolvent banks were kept open temporarily by various methods until the banking crisis in March 1933.

The Blanket Assessment Defect

One serious drawback to the Federal Deposit Insurance law is that it imposes a blanket assessment upon all banks, failing to recognize differences in risks among banks. Commercial banks,

200 Ibid.
201 Ibid., Page 17
202 Ibid.

ESTIMATED LOSSES TO DEPOSITORS OF STATE AND NATIONAL BANKS WHICH SUSPENDED DURING 1930-1932* (Exclusive of Mutual Savings and Private Banks)

(Amounts in Millions of Dollars)

YEAR	DEPOSITS OF ACTIVE BANKS June 30	CAPITAL FUNDS of ACTIVE BANKS June 30	DEPOSITS OF BANKS SUSPENDING	ESTIMATED LOSS to DEPOSITORS OF FAILED BANKS(1)	ESTIMATED LOSS WHICH WOULD HAVE BEEN BORNE By the GUARANTY FUND (2)	RATIO OF LOSSES to DEPOSITS OF ACTIVE BANKS (%)	RATIO OF LOSSES to CAPITAL FUNDS OF ACTIVE BANKS (%)
1930	$50,550	$8,943	$822	$281	$253	0.50	2.83
1931	46,770	8,326	1,669	571	514	1.10	6.17
1932	35,311	7,039	698	239	215	0.61	3.05
Annual Average for 3 years(3)	$44,210	$8,102	$1,063	$364	$327	0.74%	4.04%

(1) ESTIMATED on the basis of experience in prior years at 11% of the deposits of reopened banks and 40% of the deposits of banks placed in liquidation.

(2) ESTIMATED at 90% of the total loss to depositors because of the predominance of small institutions among failed banks.

(3) The losses in the failed banks during the above years do not tell the complete story because many insolvent banks were kept open temporarily until the banking crisis of 1933. If the banks which have been placed in liquidation in 1933 or reorganized because of financial difficulties, and the banks still operating on a restricted basis, had all closed under a guaranty plan such as the provided for in the BANKING ACT of 1933, their losses, plus those shown above for the years 1930-1932, would probably have amounted altogether to about 8% of the deposits of all banks now operating on an unrestricted basis, or about 48% of their capital funds.

*THE GUARANTY of Bank Deposits - Bulletin No. 3 - Commission on Banking Law and Practice - Association of Reserve City Bankers.

mutual savings banks, banks located in New England, banks located in the southwestern states, urban and rural banks are all subject to the same assessments. Under such a system one bank pays for the other regardless of whether or not the bank has been well managed. Such a system only strengthens the hostility of the banker toward the guaranty plan, and in his mind it encourages bad banking.[203]

An estimate of the geographical distribution of assessments and losses from 1921 to 1932 is given below:[204]

Geographic Location	Per Cent of Assessment to Total Assessment	Per Cent of Loss to Total Loss
New England States	7.6%	3.7%
Middle Atlantic States	44.0	20.0
North Central States	18.6	21.9
Southern Mountain States	3.5	5.8
Southeastern States	2.8	13.7
Southwestern States	4.3	7.0
	8.0	20.7
Rocky Mountain	1.8	4.5
Pacific Coast	9.4	2.7

Unfortunately the economic defect of the banking system remains as great as before since there is no attempt made to relate assessments to the risk. This removes a powerful incentive that would otherwise exist to raise the banking standards where they are relatively low.

Another consideration which makes a uniform assessment an undesirable feature of the Deposit Insurance law is that since all banks pay exactly the same percentage of deposit liabilities, the large bank having large deposit accounts is protected to a

203 "The Guaranty of Bank Deposits Under the Banking Act of 1933", Guy Emerson, Quarterly Journal of Economics, February 1933, Volume XLVIII, No. 2 -- Page 236

204 Ibid., Page 237

much less degree than a small bank having small accounts for the most part. The deposit insurance program provides one hundred per cent temporary insurance for accounts of $5000 or less, while under the permanent plan the maximum deposit insured to one hundred per cent is $10,000. In a large metropolitan bank the deposit accounts of many bank depositors would exceed this sum, while not many accounts in small banks in rural communities would exceed this sum. This means that the large bank gets less protection and still has to pay a larger portion of the bill. The assessment made against the large bank in proportion to the amount of insurance given the bank's customers is much larger than is the proportion for the small bank.[205]

The Interest Argument

Some defenders of the federal deposit insurance law have pointed out that the compensation provided by the prohibition of interest on commercial deposits will be sufficient to offset a considerable amount of the expense of deposit guaranty. In substantiation it is pointed out that the average interest payment for the five years preceding the prohibition of paying interest on commercial deposits amounted to $246,000,000 annually on demand deposits.[206]

This contention does not seem to stand up under close examination. In the year ending June 30, 1930, the national banks of the country paid $128,719,000 in interest on demand deposits, and paid only $66,772,000 in the year ending June 30, 1932. This figure was undoubtedly less in 1933.

[205] Ibid.
[206] Ibid., Pages 234-235

Because of the failure of commercial banks to pay interest on demand deposits, corporations and individuals have drawn down their demand deposit accounts to a minimum and in many instances these have been invested or converted into time deposit accounts.

Furthermore, many banks have paid little or no interest on demand deposits for years and will receive little or no benefit in the way of a saving to assist in meeting the assessments under a deposit guaranty scheme.

It may be pointed out also that this argument that demand deposit interest savings will offset the expense of deposit guaranty to a large extent does not take into consideration that the best of investments of today pay a very low rate of return as compared with the return of a few years ago thus making the net return to a bank on an investment little if any different from what it was when the bank paid interest on demand deposits.

Finally, this argument does not take into consideration the necessity for many banks to build up earning power and thereby replete reserves. Banks must set aside some earnings for a cushion in times of distress or to absorb losses from bad investments.

It seems quite impossible to estimate any savings for any group of banks because of net savings on demand deposits or possibly lower interest on time deposits. Above all else, one cannot logically argue that the lack of the necessity of paying interest on demand deposits will be of any appreciable help in meeting deposit guaranty assessments, to say nothing of justifying

the law on these grounds.

The Reserve Factor

It has been pointed out already that those who oppose the Federal Deposit Insurance law contend that it is weak in failing to provide adequate reserves to meet losses. It was held by the Commission on Banking Law and Practice of the Association of Reserve City Bankers that in its failure to provide for reserves, the deposit guaranty law failed to meet the requirements of an insurance program (see Page 22).

Instead of providing reserves in good times against losses in bad times the Federal Deposit Insurance laws provide for the assessment of Class A stockholders of the Corporation at any time when the fund is drawn down by the payment of depositors. This would have amounted to one-fourth of one per cent every second year prior to 1930, and from two to four times that since 1930.[207]

Mr. Aldrich, Chairman of the Board of the Chase National Bank in New York, says that this provision may check the flow of capital into banks, weaken the confidence in banks, and defeat the very purpose of the Act.[208]

The failure to make provision for a reserve fund is undoubtedly a weakness of the deposit insurance law. Such a reserve fund would avoid the necessity of taxing banks at times when they could stand the tax the least. It is in times of stress that bank failures occur.

---

[207] Ibid., Page 235

[208] Ibid.

Chapter Three

THE CASE FOR FEDERAL DEPOSIT GUARANTY

Several of the more outstanding arguments against deposit guaranty on a national basis have been stated already. It is only fair that the argument in favor of deposit guaranty be presented.

Burden of Loss Shifted From Shoulder of Depositor

The most important defense for deposit guaranty is found in the argument that it is bound to reduce the losses of depositors in closed banks. The losses to depositors resulting from bank failures prior to the enactment of the deposit guaranty legislations had been serious. Therefore, from the point of view of the depositor any system which indemnifies him against loss of his bank account when a bank fails is better than no protection. It is not surprising that the general public reaction is along this line of reasoning.[209]

The majority of depositors in banking institutions are unable to distinguish between banks as to their safety, management, etc., and from the depositor's point of view he is relieved of this burden. It was this same type of situation which made it necessary for legislation to protect the holders of bank notes in the nineteenth century. (See Pages 64-74)

Restore Confidence

It is argued also that the deposit guaranty law enacted by Congress will restore public confidence in the banking business. This restoration of confidence , it is contended, ought to

[209] Ibid., Pages 238-239

compensate in part for the burdens of the system contributing to a revival of business in which both the public and the bank will benefit.[210]

Put an End to Bank Runs

A third benefit of federal deposit guaranty is found in the benefits from putting an end to bank runs. Banks individually and collectively should benefit from the removal of the fear that an unexpected and unwarranted run may so cripple the bank as to make it necessary to liquidate its affairs. This is also a benefit to the depositor. When a bank fails because of a run, the depositor must share part of the burden of the loss.

The lessening of the run hazard in banking business has the further advantage to bankers that it will not force them to keep their investments in such a liquid condition as has been necessary prior to deposit insurance. (It can be pointed out here also that the lessened necessity for liquid investments may lead to more lax banking methods as contended to those who oppose deposit guaranty.)[211]

Distribute the Losses

Bank deposit guaranty laws can prevent the distress which follows bank failures. The losses suffered by state and national bank depositors, particularly in certain localities, have been substantial, especially in recent years. One effect of the deposit guaranty laws would be to spread the losses from bank failures more equally and over longer periods of time.[212]

---

210 Ibid.
211 Ibid.
212 "Theory and Practice of Banking", Harr and Harris, McGraw-Hill, Pages 136-137

Improve Banking Practices

There are some who believe that when all banks are compelled to contribute toward a fund to meet bank losses, the bankers have an immediate and compelling motive to improve banking conditions. As a result, bank supervision will become more effective and the undesirable bankers will be unable to stay in business. Self-interest will bring about an improvement in banking practices.

Bank Deposit Guaranty and Check Currency

The proponents of bank deposit insurance have a favorable argument in the part played by a deposit guaranty system in protecting the users of the so-called check currency.

As a medium of exchange bank deposits have replaced bank notes for the most part. It is estimated that over ninety per cent of the business transactions in the United States are carried on by means of checks against deposit accounts. The holder of this check currency can have greater confidence in its value as an exchange medium when there is confidence that the deposit account against which the check is written cannot be wiped out because the bank upon which the check is drawn may fail before the check can be presented for payment. It is argued that it is just as necessary today to protect the holders of these checks as it was to protect the holders of bank notes, when bank notes made up the principal part of the medium of exchange.[213]

In spite of the foregoing arguments, it is necessary to recognize some arguments against the desirability of guaranteeing

[213] Ibid., Pages 137-138

bank deposits in order to protect the check currency in use today.

Bank notes are accepted by anyone, and are used frequently to settle transactions between individuals and firms whose identity is quite unknown to each other. This is necessary for small transactions. Payments by check, on the other hand, are made for the most part between people whose business integrity and standing is known to each other, or about whom credit information may be had. There are already guarantees of payment of bank deposits against which checks are drawn, and to infer that deposit guaranty is needed because these are lacking is quite incorrect. There is the capital, surplus, and undivided profits of a bank and, in addition, the double liability of stockholders affords a protective margin.

Chapter Four

POSSIBLE DEVELOPMENT UNDER THE FEDERAL LAW

It is difficult for anyone to say what will happen to the banking system under deposit guaranty, and it is just as hard to forecast the outcome of the insurance program itself.

The deposit insurance law may stand just as it is. If there are no losses, the law will be hailed as the remedy; if there are more failures, it will be held to be necessary to protect the interests of depositors.

In any event, there should be a working test to measure the plan. If lax banking results as an outcome of the law, the public should be informed as soon as possible. On the other hand, if banking methods should improve under the law, it should be given credit as being the indirect cause of the improvement.[214]

Potentially, the law is a national banking system. All the banks of the country are more closely tied together than ever before in our history. This may lead to the working out of some better practices and greater exchange of knowledge among banks. To an extent, the competitive factor is lessened and all banks have mutual interest in making a profit.

A second possible outcome of the law is that it may be amended to do away with its undesirable features.[215]

The unlimited liability of banks in the case of making assessments might be removed. This provision can affect the flow of capital into banks, because unless removed it will become increasingly difficult to forecast the earnings of banks, to say

214 "The Guaranty of Bank Deposits Under the Banking Act of 1933", Guy Emerson, Quarterly Journal of Economics, February 1933, Volume XLVIII, No. 2, Pages 242-244

215 Ibid.

nothing of providing the reserves necessary for sound bank management.

It may be possible to provide for the creation of a reserve fund. This would give the law a greater chance of success and eliminate the danger to banks of having to pay excessive assessments when the burden might prove disastrous to many banks.

It may be possible also to assess costs in accordance with the risks involved. Banks should be assessed for payments to the guaranty fund in accordance with their location, their size, the type of business carried on by the bank, and the character of banking policy of the bank. All of these factors affect the risk element and ought to be recognized. A principle of scientific insurance is the charging of premiums in accordance with the risks involved.

Chapter Five

BANK DEPOSIT GUARANTY AND CREDIT INSURANCE

There are many who feel that bank deposit guaranty resolves itself into a matter of credit insurance, and state that the problem of protecting the interest of depositors can be solved indirectly by providing insurance against the failure of borrowers to repay loans.

Before bringing to a close our discussion of bank deposit guaranty, it is essential to examine the contentions of those who think the solution lies in credit insurance.

It has been stated that a bank fails because the borrowers do not pay their loans. They are either unwilling to pay or unable to pay, thus being dishonest or insolvent credit risks.

The greatest hazard of the bank then is the credit of the borrowers. To save banks from failure can we have a form of insurance to protect banks against the insolvency of the bank debtors?

C. L. Jamison says, "The insurance of credit risk is so complex that any contract which adequately protects the carrier is so hedged about with exceptions that it is likely to give little protection to the insured except at a prohibitive premium."[216]

Bank deposits can be insured in one of two ways: (1) Wait until the bank closes its doors and then indemnify depositors for the losses, or (2) prevent bank failures by indemnifying the banks directly for credit losses as they are incurred.

The first method would deprive communities of their banking

---

216 "Bank Deposit Guaranties, the Insurance Aspects of the Problem", C. L. Jamison, Bankers' Magazine, Volume CXXVI, January-June 1933, Page 452

services and make great inconveniences for bank creditors through forced liquidation of assets. It is exactly what is done now when a bank fails.

Under the second method, the bank carries on as a solvent institution without disturbing the relation between the bank and its customers. Is it true then that bank deposit insurance differs little from mercantile credit insurance as carried on in the United States? If so, bank deposit insurance can be an indirect benefit to depositors when the payment is made directly to the bank by the borrower.

Deposit insurance, however, is blanket coverage and this form of insurance has been found to be entirely impracticable in the field of credit insurance. There is no reason to believe, therefore, that it would work better if applied to bank deposit insurance.[217] (This does not mean that blanket coverage cannot be carried on in certain insurance fields; it has been done successfully in group insurance.)

If credit insurance were to be applied to bank deposits, there would be the problem of selecting the risks. Once a policyholder is secured, he could not be relied upon to deal with even reasonably safe debtors. The insurance company would have to state the class of debts that were coverable under the policy.

The selection of risks would have to be done by means of special investigations and by relying upon information furnished by mercantile agencies. The first method is very expensive, and the second is not altogether satisfactory because the information

[217] Ibid.

is not sufficiently specific.

In the matter of credit risk insurance there is the problem of diversification also. The risks must be spread over many debtors and not too large in size. Bank deposit insurance on a national scale would give the diversification needed, however, and the problem would resolve itself into one of determining the maximum size of coverage for insurance.

Another problem of concern to the banker is the matter of bearing the cost of the insurance. If the banker had to carry the burden, it would sober his judgement, provided he were unable to shift the burden to the depositor; this is not altogether likely under a banking system where all banks will be faced with the same problem, thus making possible little discrimination in lending rates. However, the banker would have more information about his risks if he were obliged to examine the risk of each one.

There is the possibility that banks could pay the cost of insuring the excess losses only. This immediately creates the problem of deciding where excess loss begins and is not a likely accomplishment.

There would be still be the "catastrophe hazard" even if credit insurance were used to insure the doubtful loans. There is no guarantee that when such insurance is most needed, as in times of depression, that the insurance companies would be willing to assume the risks.

Finally, there is the matter of proof of loss. In the case

of life insurance the loss is known when the insured dies, and in fire insurance when there is a fire. Who knows when a bank debtor can repay his loan? Who knows how much he can repay? The loss is known only when every means known to press payment has been used without success.

"The conclusion is inevitable that if any known method of managing credit insurance were to be applied to a system of bank deposit guaranties[218], the project would be so shot through with complications, so honeycombed with vague uncertainties that its successful operation is gravely doubtful. The most that can be said for it is the confidence that such a guaranty would instill into the minds of timid depositors; confidence in the security of banks is a prime necessity, but let us find some other way if possible of inspiring that confidence."[219]

[218] "Bank Deposit Guaranties, the Insurance Aspects of the Problem", C. L. Jamison, Bankers' Magazine, Volume CXXVI, January-June 1933, Page 451

[219] Ibid.

Chapter Six

SUMMARY AND CONCLUSIONS

Summary

A summary of the conclusions and statements concerning bank deposit guaranty in the United States made thus far is of great assistance in formulating final conclusions on the subject.

It was concluded in Part I that bank deposit guaranty is bank deposit insurance, being a kind of insurance called assessment insurance.

It was stated in Part II that bank deposit insurance is one step in the evolutionary growth of laws enacted by legislatures to protect the interest of depositors in banking institutions. The laws regulating bank organization, bank investments, and bank supervision have been enacted to protect the public's interest in the banking business. Bank deposit insurance laws were shown to be one of the more recent attempts at such regulation.

It was shown in Part III that the deposit guaranty idea has been practiced before on a state basis, eight of the western states attempting to guarantee bank deposits by compulsory or voluntary plans during the period from 1908 to 1930. It was shown how this movement having its origin in the Populist Party of the west failed in every instance. The reasons for this failure were many, but among the outstanding reasons were the following: Banks were admitted to the deposit guaranty systems which should have been excluded; the plans were administered by politicians whose training in the field of banking was far from adequate for

the proper functioning of the plans; and the banking practices in all of the states became lax during the operation of the laws. It was shown how in each case economic conditions in the United States during 1920-1921 brought a pressure on these systems which could not be borne by them.

In Part IV it was shown how that the economic conditions of the country following the World War had such a serious effect upon banking conditions in the country that the system collapsed early in 1933 when the President proclaimed a national bank holiday. Following the bank holiday the Federal Deposit Insurance Corporation was created to insure bank deposits in national banks, members of the Federal Reserve System, and all non-member banks wishing to participate. On July 1st, 1934, the Temporary Insurance Fund went into effect. Its life has been extended.

In Part V an attempt has been made to show the futility of deposit guaranty on a national basis in terms of what might have happened had it been in existence from 1920 to 1932. In addition, some of the defects of the law have been pointed out. On the other hand, the case for deposit insurance has been presented. The possible development of banking reforms under a national guaranty law have been discussed and, finally, it was shown how "credit insurance" could not cope with the problems of guaranteeing deposits.

Conclusions

The foregoing brief summary of this study of bank deposit guaranty in the United States furnishes background for the

presentation of conclusions on the subject.

Deposit Insurance and Banking Reform

The prospect that losses to depositors will be reduced is of great significance to the depositors, but the realization of this does not lessen the real problem. The real problem is to eliminate the losses altogether.[220] The net loss is the same to society whether the losses resulting from bank failures are borne by the depositors, by the banks, or by the stockholders of banking institutions. It is very desirable to make a wider distribution of the losses, but if society is to benefit, the losses must be eliminated.

In the last analysis the deposit insurance legislation enacted by Congress, must be judged on whether it lessens bank failures. To distribute the losses is merely patchwork. Bank failures can be eliminated only when the banking practices of the nation improve, and when banks conduct themselves in the best interest of the depositor on a conservative basis.

There is real need for more professional bankers and less conduct of banking by men to whom banking is an avocation rather than a real vocation. Banking is a profession and should be practiced only by those who regard it as such and who must, therefore, live up to professional standards that are not conducive to lax banking methods. Any reduction of losses must come indirectly, not directly. Deposit insurance as it exists now cannot produce the desired results directly. It can afford the incentive needed to reform the banking laws and improve the

220 "The Guaranty of Bank Deposits Under the Banking Act of 1933", Guy Emerson, Quarterly Journal of Economics, February 1933, Volume XLVIII, No. 2 -- Page 240

conduct of the business.

Sound banks have cause for forcing banking reform. It can be done and should be done before it is too late. There are likely to be fewer banking failures during the next few years because of an improvement in the banking structure. The weaker banks were forced into liquidation by the banking holiday, and those that had been limping along have been greatly strengthened. People are apt to think that the remedy for bank failures and losses to depositors has been found, and if so, it will be hard to press needed banking reforms. This will allow practices to continue that may destroy the foundation of the banking structure before the public realizes that the deposit insurance program is merely a protective roof under which dishonest practices are fostered.

A GRADUATE SCHOOL OF BANKING

There is no way that sound banking practices can be assured any more definitely than to improve the calibre and business integrity of the men and women who enter the banking business as a profession.

A fundamental weakness of banking as practiced in the United States today is that principle which allows men to enter the banking profession regardless of the experience they have had in the conduct of the business. It is possible for any man who desires to enter the banking business, provided he can satisfy the requirements of the state laws regarding financial responsibility, dwelling place, and apparent honesty. There are practically no laws which require that the would-be banker must have fundamental knowledge of banking principles, economics, law, etc., and although a bank can be successfully operated by men whose training in business, economics, and banking has not been carried on in a formal manner, there are many bank failures caused through lack of knowledge of these fundamental principles. This does not mean that all bank failures are directly attributable to this cause, but aside from dishonest management it is one of the more important contributory factors making for unsuccessful banking.

The conduct of banking is a profession. The business is not one which can be managed by anyone to whom the business appeals. It must be conducted on a basis of sound judgement backed up by thorough knowledge and understanding. Experience is a big factor, but experience alone cannot give one the fore-

sight and vision necessary to avoid all the pitfalls. In foreign countries banking has been recognized as a profession for many years. A man whose forefathers had not followed the banking business would stand but little chance of becoming a banker. In England the conduct of the business itself is entrusted to men who have served an apprenticeship of many years following a period of formal training in banking principles. On the other hand, in the United States the banking business is far from being a profession. Experience is only a desirable factor and men are selected for important posts in banks for the size of the account they can bring to the bank rather than for what real knowledge of the business they possess. These men regard the bank with which they are affiliated as an avocation rather than a vocation.

In recognition of these facts a recent announcement made by the American Bankers' Association Public Education Commission Chairman is of great significance and should have more influence in bringing order out of chaos in the banking business than any laws that could be enacted. The announcement was that of a "Graduate School of Banking".[221]

Mr. John H. Puelicher, the Chairman, says: "One of the constructive trends in the business world during recent years has been the evolution of banking as a profession..... The banker, of course, is fundamentally a combination of business and professional man, although the professional aspects of banking have been obscured by the fact that bankers are not required

221 "The Graduate School of Banking", John Puelicher, The Journal of the American Bankers' Association, February 1935, Pages 42-43

to pass a prescribed course of study. Also there has been the tradition which held that the best way to become a banker is to "learn the business by experience". A practical knowledge of economics, intelligent conservatism, personal integrity, skill in handling men, and the sixth sense of sound judgement have been and always will be considered essentials of the banker's background..... To this has been added a personnel trained in theory as well as practical banking. In short, academic preparation, necessitated to some extent by the ramifications of modern business, has taken its place with practical experience, and today the two are virtually inseparable."[222]

The new school is to be opened at Rutgers University at New Brunswick, New Jersey, on June 16, 1935, and is an outgrowth of the work of the American Institute of Banking.

It is planned that the Institute will continue its formal programs in its chapters. Enrollment in the Graduate School, however, will be confined to properly qualified bank officers. The courses will constitute an intensive study of managerial policies extending over a period of two years with six weeks spent in resident instruction at Rutgers, and twenty months in extension work under supervision of the faculty of the Graduate School of Banking.

The curriculum in the Graduate School will embrace three major subjects: bank management, trust administration, and the bank's investment portfolio. The courses will be taught on a major and minor basis during resident sessions. Each subject is

[222] Ibid.

to be offered as a major for two hours each morning during resident sessions, while on three afternoons of each week the same subjects will be offered as minors. Bank officers in attendance will have to take one major and one minor. In addition they will be required to study courses in banking law, ethical and economic phases of banking.

This announcement has been given relatively little publicity but so far as the conduct of American Banking is concerned, it is one of the most significant announcement in decades. It is a recognition that banking has evolved into a profession here as well as in Europe. It is a first step toward better banking through self-discipline and training rather than by the imposition of well-meant legislation.

HOW A GUARANTY IAW COULD BE JUSTIFIED

The conditions in the banking world subsequent to the World War and until the Banking Holiday of March 1933 are not likely to recur again for a number of years. After the bank holiday only the sound banks were allowed to reopen and it was announced by the administration in Washington that it would permit no more epidemics of bank failures.[223] If this promise is carried out, bank failures will be few in the years to come.

Under such conditions a deposit guaranty law would be workable, and the same time it would be uncalled for. This is the dilemma of deposit guaranty.

The only conditions under which the law is justified is one wherein the agency paying all the bills (the solvent banks or

[223] "The Futility of Deposit Guaranty Laws", Frederick A. Bradford, Bankers' Magazine, Volume 126, 1933 -- Pages 537-539

the Government) must be able to so regulate the banking business as to stop bank failures. If this is done, there is no need for deposit guaranty and, therefore, it becomes of no importance.

A parallel of this situation is found in the following case. The Federal Reserve notes of the United States are guaranteed, yet the guaranty is a mere formality since the operation of the Federal Reserve Banks is so regulated as to insure the soundness of the notes issued. The deposits of the member banks in the Federal Reserve Banks are not guaranteed, yet the safety of these deposits is considered as good as the safety of the Federal Reserve note. Under such conditions a guaranty becomes a matter of indifference.[224]

It is essential to have a soundness of bank assets before any guaranty system can work.

IMPORTANT FEATURES of the STATE GUARANTY LAWS

STATE	LAW PASSED	PRESENT STATUS	PARTICIPATION	DEPOSITS AS SURETY FOR PAYMENT OF ASSESSMENTS	REGULAR ASSESSMENTS	SPECIAL ASSESSMENTS	MAXIMUM ASSESSMENTS	ADMINISTRATION OF GUARANTY FUND.	CUSTODY OF GUARANTY FUND
OKLAHOMA	DEC. 17, 1907.	REPEALED 1923.	Compulsory	Deposit with board, securities equal to 1% of average daily deposits minimum $500. New banks to pay 3% of capital Stock to Guaranty Fund.	Annually 1/5 of 1% of average daily deposits until fund should reach 2% of average daily deposits.	1/5 of 1% of average daily deposits in years 1914 - 1916. None after 1916.	1/5 of 1% of average daily deposits, in any one year.	State Banking Board.	75% in State warrants or similar securities, 25% held as cash reserve by board.
NEBRASKA	MARCH 6, 1909.	REPEALED 1930	Compulsory	New Banks to pay 4% of their Capital Stock to fund when opening for business.	Semi-annually 1/4 of 1% of average daily deposits until fund should reach 1½% of deposits.	If fund should fall below 1% of deposits, assessments not exceeding 1/2 of 1% of daily deposits in any one year.	Must not exceed 2/3 of 1% of daily deposits in any one year.	Guaranty Fund commission Secretary of Commerce and one member from each of 7 banking districts appointed by Governor.	Held in Custody of banks, subject to payment on demand to Commission. (See text for bankers Conservation fund.)
MISSISSIPPI	MARCH 9, 1914.	REPEALED 1930	Compulsory	Deposit cash or securities with treasurer to amount of $500 for every $100,000 of deposits less Capital Stock and Surplus.	Annually 1/2 of 1% of average daily deposits less capital and surplus until fund should reach $500,000.	In an emergency 4 extra assessments of 1/40 of 1% in any one year.	Must not exceed 5 assessments of 1/20 of 1% in any one year.	State Superintendent of Banks.	Held in state depository banks subject to order of State treasurer.
SOUTH DAKOTA	MARCH 13, 1915.	REPEALED 1925 REINSTATED 1926 REPEALED	Compulsory	New Banks to pay 4% of Capital stock when opening for business.	Annually 1/4 of 1% of average daily deposits until fund should reach 1½% of deposits to be resumed when fund Should fall below 1% of deposits.	No special assessments.	Must not exceed 1/4 of 1% of average daily deposits in any one year.	Guaranty Commission, Superintendent of Banks and 3 persons selected by Governor and recommended by State Bankers Association.	Fund in Custody of banks subject to payment on demand to Commission.
NORTH DAKOTA	MARCH 10, 1917.	REPEALED 1929.	Compulsory	New banks to pay 3% of their Capital Stock to Guaranty Fund.	Annually 1/2 of 1% of average daily deposits until fund should reach 2% of average daily deposits, when assessments cease until fund is below 1½% of daily deposits.	In an emergency 4 extra assessments of 1/20 of 1% in any one year.	Must not exceed 5 assessments of 1/20 of 1% in any one year.	Depositors guaranty fund Commission composed of Governor, manager of Bank of N.D., and 3 others appointed by governor and recommended by banks.	Fund in custody of banks subject to payment on demand to commission.

NOTE: Source: "THE GUARANTY OF BANK DEPOSITS" by John G. Blocker Bureau of Business Research, Kansas Studies In Business 1929, and "Deposit Guaranty In Practice", Literary Digest, June 10, 1933.

IMPORTANT FEATURES OF THE STATE GUARANTY LAWS

STATE	LAW PASSED	PRESENT STATUS	PARTICIPATION	DEPOSIT AS SURETY FOR PAYMENT OF ASSESSMENTS	REGULAR ASSESSMENTS	SPECIAL ASSESSMENTS	MAXIMUM ASSESSMENTS	ADMINISTRATION OF GUARANTY FUND	CUSTODY OF GUARANTY FUND.
KANSAS	MARCH 6, 1909	REPEALED 1929	Voluntary	Deposit with treasurer cash or securities to the amount of $300 for every $100,000. of deposits less capital and surplus.	Annually 1/20 of 1% of average guaranteed deposits, less capital surplus, until fund should reach $1,000,000.	Additional assessments if fund should fall below $500,000.	Not more than 3 assessments of 1/20 of 1% in any one year.	Bank Commissioner	Held in State Depositary Banks subject to order of bank commissioner.
TEXA	AUGUST 8, 1909	REPEALED 1927.	Voluntary Optional whether banks select guaranty plan or Bond security system	Deposit with board 1% of average daily deposits of year preceding membership. New banks pay 3% of capital stock and surplus to board.	Annually 1/4 of 1% of average daily deposits until fund should reach $5000,000.	In case of depleted fund or emergency, board might levy 2% of average daily deposits.	Must not exceed 2% of average daily deposits.	State Banking Board	25% of each assessment deposited with State treasurer. 75% in custody of banks, subject to payment on demand.
WASHINGTON	MARCH 10, 1917.	REPEALED 1929	Voluntary.	Deposit with treasurer Securities to value of $1,000 for every $100,000 of deposits.	Guaranty fund annual credit on books of banks of 1% of average daily deposits. Contingent fund annually 1/10 of 1% of average daily deposits in cash reaching 1% of deposits.	Extra assessments not exceeding 1/2 of 1% of deposits.	Guaranty Fund: Not to exceed 1 1/2% of daily deposits. Contingent Fund: Not to exceed 1/10 of 1% of average daily deposits.	Guaranty Fund board composed of Governor, State examiner, and 3 others appointed by Governor.	Guaranty Fund- a credit on books of each member, subject to payment on demand. Contingent Fund- a cash fund held by State treasurer.

NOTE. The "Guaranty Of Bank Deposits" by John G. Blocker, Bureau of Business Research, Kansas studies in Business, 1929.
and - "Deposit Guaranty in Practice", Literary Digest, June 10, 1933.

BIBLIOGRAPHY

Books

"The Guaranty of Bank Deposits" Thomas B. Robb (Houghton Mifflin Company, 1921)

"The Guaranty of State Bank Deposits" John G. Blocker, Bureau of Business Research, Kansas Studies in Business, No. 11 (July, 1929)

"Banking Theory and Practice" Harr and Harris (McGraw-Hill)

"Banking" F. A. Bradford (Longmans, Green and Company) 1932

"The Federal Reserve System in Operation" E. A. Goldenweiser (McGraw-Hill)

"History of Banking in The United States" John J. Knowx (Bradford Rhodes and Company, 1900)

"Contemporary Banking" H. P. Willis, J. M. Chapman, R. W. Robey (Harper and Brothers, 1933)

"Insurance, Its Theory and Practice" A. H. Mowbray (McGraw-Hill)

"Handbook of Insurance" C. J. Crobaugh (McGraw-Hill)

"Senate Document" Vol. 28, 63rd Congress 2nd Session, 1914

"State Banks, Trust Companies, and Independent Treasury System" (Publication of National Monetary Commission Vol. VII)

"The Banking Situation" (American Post War Problems and Developments) H. P. Willis, and J. H. Chapman (Columbia University Press, 1934)

Bank Deposit Insurance, Edited by John Edson Brady, The Banking Law Journal, Cambridge, Massachusetts, 1933

"The Outline of 'New Deal' Legislation of 1933" Howard S. Piquet, (McGraw-Hill)

"Elementary Principles of Economics" Irving Fisher (Macmillan, 1928)

Magazine Articles

"Bank Deposit Guaranty, The Insurance Aspects of The Problems" by C. L. Jamison, Bankers Magazine, Vol.CXXXVI (January June 1933)

"The Collapse of Bank Deposit Guaranty in Oklahoma and Its Position in Other States" Thornton Cooke, Quarterly Journal of Economics, Vol. 38, No. 1

"How Nebraska Sowed Deposit Guaranty and Reaped Bankruptcy" Executives Magazine, October 1933, Vol. XVII, No. 5

"How Kansas Bank Deposit Insurance Failed to Insure" Executives Magazine, November 25, 1933, Vol. XVII, No. 6

"Deposit Guaranty in Kansas" F. S. Wetlock, Bankers Magazine, Vol. CXIII

"The Price of Deposit Insurance" F. M. Law, American Bankers Association Journal, (February, 1933)

"Futility of Deposit Guaranty Laws" Frederick A. Bradford, Bankers Magazine, Vol. 126

"The Guaranty of Bank Deposit Under the Banking Act of 1933" by Guy Emerson, Quarterly Journal of Economics, February, 1933, Vol. XVIII, No. 2

"Mutual Savings Bank Insurance Funds, Philip A. Benson, American Bankers Association Journal, August, 1934

"Four Years More of Deposit Guaranty" Quarterly Journal of Economics, November, 1913, Vol. XXVIII, No. 1

"Barrons" June 12, 1933

"A Crisis in Deposit Guaranty in the State of Washington" Howard Preston, Quarterly Journal of Economics, February, 1922

Bankers Magazine, April, 1930, Vol. CXX, No. 4

"Guaranty of Deposit Proposed as Unfair at Hearing etc. Commercial and Financial Chronicle, April 9, 1932

"Federal Guaranty for Deposits in National Banks" Commercial and Financial Chronicle, January 4, 1930

"The Guaranty of Bank Deposits Is Constitutional" Outlook, January 11, 1911

"Limits of Insurance" The Saturday Evening Post, August 9,1924

"Voluntary Bank Deposit Insurance" C. Crawford, "The Independent" March 18, 1902

"Federal Guaranty of Bank Deposits" Editorial, The Bankers Magazine, April, 1932

Walter W. Head on "Fallacy of Bank Deposit Guarantee" Commercial and Financial Chronicle, May 17, 1924

Pamphlets

"The Guaranty of Bank Deposits" Economic Policy Commission American Bankers Association

"The Guaranty of Bank Deposits" Bulletin No. 3 Commission on Banking Law and Practice, Association of Reserve City Bankers

"Preliminary Summary of Certified Statements" F. D. I. C. Issued by Statistical Davision, January 12, 1935

"Preliminary Report of The Board of Directors of the F. D. I. C. on Operations to June 30, 1934"

"Address of the Hon. Leo T. Crowley, Chairman of the Board of Directors of the Federal Deposit Insurance Corporation Before the American Bankers Association Convention"

Laws

"Act of 73rd Congress Entitled 'Banking Act of 1933'"

"Amendment to Section 12B of the Federal Reserve Act" State of Wisconsin, Banking Law Review (Ch. 222)

Massachusetts General Laws, Chapter 44, Acts of 1932

Massachusetts General Laws, Chapters 167, 168, 172

BOSTON UNIVERSITY
1 1719 02546 0470